
CHAPTER 6. PROJECT MONITORING

SECTION 1. ON-SITE MANAGEMENT REVIEWS

On-site reviews are an integral part of the Housing Management Division's monitoring of project operations. While desk reviews of project reports (monthly and annual accounting reports, Multifamily Information Processing System MIPS printouts, and mortgagees, physical inspection reports) can alert Loan Servicers to general financial and physical trends in project operations, such desk reviews do not, by themselves, enable servicers to determine the extent or cause of the problems detected in desk reviews or to identify other deficiencies in operating procedures or physical conditions that could threaten project viability. On-site reviews can assist HUD staff in making these determinations and in resolving project problems. On-site reviews should be considered as an extension of HUD's efforts to ensure that HUD programs are administered as intended as well as to ensure that fraud, waste and mismanagement do not exist. On-site reviews can also provide documentation to support enforcement actions which become necessary when owners/agents will not voluntarily implement corrective actions. The following sections will provide examples of how the Management Review information-gathering exercise should proceed. The categories listed under each type of visit/review are not exhaustive. Field Offices are required to be familiar with additional requirements that may be examined. Examples of these requirements are provided in Section 2 of this Chapter.

6-1. APPLICABILITY.

- a. Insured Projects and Projects with HUD-Held Mortgages. Field Offices are required to follow these requirements for all Insured, Subsidized and projects with HUD-held mortgages unless specifically directed otherwise in this Chapter.

Field Offices are not required to complete recurring on-site reviews of:

- o FmHA, State-Agency or other projects that are adequately monitored by a Contract Administrator,
- o Decontrolled Section 608 insured projects, or
- o Nursing homes and hospitals that are being monitored by a health or regulatory agency.

Field Offices should request that the Department of Health and Human Services, State Housing Agency or state/local regulatory agency provide the Field

Office with copies of their inspection reports. While Field Offices are not required to routinely conduct reviews of these projects, Field Offices should conduct reviews when other servicing activities indicate that problems are developing.

- b. Non-Insured Projects.
- Formal Management Reviews, as described in this chapter, may be performed in connection with a physical inspection on non-insured projects even though the Secretary is not contingently liable on a contract of mortgage insurance and there is no risk of claims against the insurance fund. A Management Review may be deemed necessary, in conjunction with other aspects of this Handbook Chapter such as On-Site reviews, File Reviews and desk reviews (Annual Financial Statements, if required), to enable Field Office staff to determine if the owner/agent is providing decent, safe and sanitary housing and is complying with HUD's occupancy requirements and financial requirements for limitations on distributions.

Field Offices must conduct physical inspections of non-insured assisted housing where HUD is the Contract Administrator and has primary responsibility for physical inspections. This inspection is intended to determine whether units under contract are being maintained to HQS standards, at a minimum. Additionally, where HUD acts as the Contract Administrator, Field Offices are strongly encouraged to use the Management Review process using the form [HUD-9834](#) to complement physical inspections in project reviews required by the terms of the subsidy contract.

- c. Condominiums Insured Under Section 234.
- Only physical inspections are required on these projects until they become Single-Family responsibility. As a preventive tool, Field Offices should complete physical inspections every three years, if the project continues to be a Multifamily Housing responsibility. Inspections must also be completed when other requirements of Chapter 6, Section 1.6-5.c., exist.

6-2. LEVELS OF ON-SITE MANAGEMENT REVIEWS.

On-site management Reviews may be divided into two categories: Comprehensive and Limited. The timing of these reviews should be accomplished according to Section 1.6-5. of this Chapter while the determination of the scope of the review should be made in accordance with this Section and Section 1.6-6. of this Chapter. The exact nature of these two categories is described as follows:

- a. Comprehensive Management Reviews are intended to be a complete and detailed look at the systems and procedures in use at the project, covering all aspects of project management. They are designed to assist the Loan Management Staff in detecting operational deficiencies, determining the cause of project problems and in structuring management improvement programs in concert with project owners and managers. As a complete review, all questions of the Management Reviews of Multifamily Projects, Form [HUD-9834](#), must be answered. All 45 questions in the following six Sections must be answered:

- A. Maintenance and Security,
- B. Financial Management,
- C. Leasing and Occupancy,
- D. Tenant/management Relations,
- E. Drug-Free Housing Policy, and
- F. General Management Practices,

Form [HUD-9834](#) must be answered in its entirety in order to complete the Summary Page. This form is found in Appendix 1. Detailed procedures for completing this form are given in the form itself and in Section 2 of this chapter.

- b. Limited Management Reviews are intended to focus on those areas most likely to generate problems in a project. This type of review should be done on a schedule determined by the Loan Management Branch Chief. Such reviews should not replace Comprehensive Management Reviews. Limited reviews should be done on an intermittent, as needed, basis. If a limited Management Review is performed on the basis of a known or suspected problem area it is because of the assumption that the likelihood of mismanagement increases with each warning indicator. Therefore, a limited Management Review should include at least the one

problem area in addition to the 17 required areas described below. If more than one indication of a trouble area is found when the servicer is reviewing documentation to determine whether to conduct a review and/or the extent of the review to be conducted, a Comprehensive Management Review may be indicated.

A limited review requires the completion of the 17 questions with shaded lines on the Summary Page of the Form [HUD-9834](#). The specific questions included in a limited management review are Questions 1, 3, 5, 8, 11, 12, 16, 20, 23, 24, 25, 28, 35, 38, 41, 42 and 43. These questions must be answered by responding to all sub-elements contained in the form. If serious deficiencies are noted during the limited review, a Comprehensive Management Review must be scheduled.

- c. Preparation for determining the level of a potential Management Review. Guidance for the loan servicer to use in preparing for a potential Management Review is listed below and is repeated in other sections of this Handbook chapter. In reviewing paper records the servicer must decide whether a Management Review must be conducted and/or the extent of the review. Among other considerations that may be known to the loan servicer, it is important to understand the relationships among the pieces of information that may be reviewed. Any one of these considerations may present a biased picture. When viewed as a total picture, all possible elements may give the servicer the most well-rounded look at a project without the need for an on-site visit. This paper review, however, will never take the place of a physical inspection or on-site Management Review when there is any indication of the need to see the project first-hand. Field Offices will be required to prioritize project portfolio need for Physical Inspections according to criteria listed in both Section 2 and Section 3. If a Physical Inspection is indicated for a high priority project, the strong relationship between physical condition and overall management of a project would strongly dictate the need for a concurrent Management Review.

Records that may be reviewed prior to deciding if a Management Review is necessary or determining the level of the Management Review are the following:

- o Status priority order according to the listing provided in Section 1.6-5.d. of this Chapter (this priority listing is interrelated with other variables below),
- o The owner's and agent's previous records on both the project under scrutiny and other projects owned or managed by those individuals,
- o Quality, scope and results of previous on-site reviews,
- o Results from recent FHEO reviews,
- o The project's age and physical condition,
- o The project's financial condition, including review of the IPA's report on the last annual financial statement,
- o Early Warning System indications taken from, for example, MIPS applications relating to current project conditions,
- o Results of Occupancy Specialist desk reviews of subsidized project certifications/recertifications and vouchers,
- o Review of local police reports, if available, and
- o Review of mortgagee physical inspections under the following circumstances:
 - 1) If the physical inspection has been performed, as required on a calendar year basis for insured projects by Mortgagee Letter 88-22, and
 - 2) If the physical inspection detailed on form HUD-9822 has been adequately performed.

Inspection results must then be reviewed to determine if the condition of the property is consistent with provision of decent, safe and sanitary housing.

6-3. TYPES OF ON-SITE VISITS. On-site reviews may be grouped into three categories: Management Reviews, File Reviews and Inspections.

a. Management Reviews.

While Management Reviews do take a big picture look at a project's physical conditions, such reviews focus primarily on policies and procedures. Management Reviews evaluate the adequacy of both the procedures for carrying out day-to-day, front-line activities (e.g., maintenance, leasing) and the procedures for directing and overseeing project operations. Management Reviews must consider all of the management tasks listed on the Form [HUD-9834](#), Management Reviews of Multifamily Projects, combining information gathered from tenant file reviews as well as other sources such as physical inspection reports, unit inspections, and site visits. Detailed procedures for completing Form [HUD-9834](#) are provided in the form itself and in Section 2 of this chapter.

b. File Reviews.

- i. Tenant File Reviews. Tenant file reviews are completed only on subsidized projects. These reviews consist primarily of detailed audits of the occupancy paperwork that owners/agents are required to complete on individual tenants. These reviews determine whether the project is complying with the HUD requirements set forth in Handbook 4350.3, Occupancy Requirements for Multifamily Housing Programs. Tenant File Reviews also consider management tasks listed below and under Section 2.6-9. of this Chapter 6, including, for example, application of "Preferences" in establishing tenant waiting lists, if any waiting lists are kept, "Alien", and "Handicapped" requirements.

This section should combine results of exception reports from the Tenant Rental Assistance Certification System (TRACS) database. Additionally, if separate Tenant Complaint Files are maintained, then the Field Office should handle tenant complaints as required under Chapter 6, Section 1. 6-3.b.iv. If tenant complaints are contained in the tenant project files, requirements of 1.6-3.b.iv. are to be addressed here.

The tenant file review consists of a detailed review of a reasonable sample of tenant files, including project waiting lists. The Management Review may detect that problems exist (e.g., recertifications are past due), and the tenant file review may complement by determining the scope of the problem and the type of action needed.

FIGURE 1
TASKS USUALLY REVIEWED AS A PART OF TENANT FILE REVIEW

ROUTINE PROCEDURES

- o Application Intake and Screening of Applicants
- o Verification Procedures
- o Application of Preferences in Tenant Waiting Lists/Selection
- o Calculation of Annual Income and Tenant Eligibility
- o Calculation of Tenant's Rent and Assistance Payment
- o Move-In Procedures
- o Leases
- o Charges Other Than Rent
- o Increases in Contract Rents/Utility Allowances
- o Regularly Scheduled Recertifications
- o File Maintenance

SPECIAL PROCEDURES

- o Interim Recertifications
- o Termination of Assistance
- o Move-Out Procedures
- o Termination of Tenancy
- o Section 8 Special Claims
- o Owner/Agent Follow-Up on HUD Review Findings
- o Income Mix
- o Occupancy Reporting
- o Voucher and HUD-50059 Submissions
- o Training and 'Supervision of Staff

- ii. Annual Financial Statement Reviews. Financial Statements submitted by owners/agents of insured projects are reviewed on an annual basis. This review attempts to measure the current and near-term financial stability of the project by using specific indicators. Reports from existing MIPS system applications should be used to

provide additional information. If the project is currently experiencing financial difficulties, or is anticipated to experience such problems within the coming year, the Field Office may take steps to forestall and prevent these problems from resulting in an insurance claim.

- iii. Police Reports. Review of local police reports, if obtainable from project files or local Police Departments, can provide critical information on project conditions and management. Owners/Agents are strongly encouraged to maintain all police reports concerning their project. Such reports should be reviewed carefully with respect to current HUD policies to include:
 - o Stated and implied physical security problems,
 - o Arrests and/or observation of drug use in and around the project, and
 - o Arrests of illegal aliens with addresses listed in the project.
- iv. Tenant Complaint Files. If the project maintains complaint/service request files, either in individual tenant files or in a separate file, the loan servicer should review these files in order to examine project compliance with current Department guidance related to:
 - o Physical security,
 - o Maintenance and upkeep in order to provide decent, safe, and sanitary housing,
 - o Presence of lead-based paint,
 - o Fair Housing and Equal Opportunity issues,
 - o 504 Discrimination against the handicapped,

-
- o Mobility problems of handicapped residents, and
 - o Drug use/sales in and around the project.

c. Inspections.

- i. Physical Inspections. Physical inspections take a detailed look at the condition of a project's buildings, grounds and mechanical systems. Section 3 of this Chapter details the process of performing required Physical Inspections using form HUD-9822, Physical Inspection Report, provided in Appendix 2.

Field Offices are required to perform Physical Inspections in accordance with Section 3 of this Chapter. These inspections examine the items listed on Form HUD-9822, Report of Physical Condition, and attempt to determine whether preventive and corrective maintenance are being performed in a regular or timely fashion. When required (e.g. for troubled/potentially troubled projects) Physical inspections made by HUD staff may duplicate or overlap the mortgagee physical inspection. A physical inspection done by the Department is not to take the place of the mortgagee physical inspection, required on a calendar year basis unless a mortgagee physical inspection is not accomplished or not performed in an acceptable fashion. An unacceptable or unperformed inspection is, however, one condition under which HUD staff must perform the inspection. (See Section 3 for further discussion of requirements for Field Offices to conduct Physical Inspections and Section 3.6-19. for remedies for mortgagee non-compliance.)

Information valuable to a complete Management Review may be obtained through this inspection, whether accomplished by HUD staff or the mortgagee. Additionally, Field Offices are strongly encouraged to perform a Management Review concurrently with the Physical Inspection. In using the Form HUD-9822, HUD staff should note drug use or evidence of such drug use in Part E of the

4350.1 REV-1CHG-5

form. Additional requirements for such physical inspections may be found in Section 1.6-5.c. and in Section 3.6-17.a.

- ii. Unit Inspections. When conducting any of the above types of reviews, HUD staff should inspect the interiors of a reasonable sample of units. The number of units inspected may vary according to the owner's/agent's previous management record, the adequacy of the agent's procedures and general physical condition of the property.
- iii. Site Visits. These include drive-by inspections and brief walks around the project grounds. According to Section 3 of this Chapter, HUD Field Office Staff are encouraged but not required to perform a drive-by or walk-through inspection when in the proximity of HUD-Held, direct loan, insured or assisted projects only when on official HUD travel and time permits. These visits can alert HUD staff to early stages of maintenance problems and help staff monitor owner/agent progress in correcting problems.

6-4.

INTERRELATIONSHIPS.

On-site Management Reviews are designed to be used in conjunction with other Housing Management Reviews (Physical Inspections, Tenant File Reviews, Annual Financial Statement Reviews). Although Management Reviews should not duplicate other review activities, the information gathered from other sources should be used in constructing the Form [HUD-9834](#). Overlap among the types of review activities is expected. This redundancy works to the advantage of HUD as long as appropriate information is shared among the many different types of review. Because of this overlap, the servicer conducting or preparing to conduct a Management Review should remain alert for fraud or abuse indications such as diversions of assets and other regulatory or criminal violations. Servicers should be aware of what potential violations may exist, to record and report such violations. Servicers may consult Program Integrity Bulletin P-88-5, Misuse and Diversion of Funds: HUD-Insured and HUD-Held Multifamily Projects, for more information.

- a. Relationship of Management Reviews to Physical Inspections. The maintenance and security section of the Management Review takes a "big picture" look at the project's physical condition, always with an eye toward Departmental Multifamily Housing Management requirements that can be visibly identified. The most important overall question, "Is the project well-maintained?" must be answered with the understanding of how physical appearance meshes with the project's:
- o current and future financial stability,
 - o provision of decent, safe, sanitary housing, and
 - o role as a representative model of what tenants and local citizens should expect from a HUD-subsidized and/or insured project.

Mortgagee Physical Inspections using the Form HUD-9822 take a more detailed look at the physical condition of a project and are an important determinant in the decision to conduct a Management Review. Nonetheless, HUD staff should be alert to nonexistent, incomplete or inadequate mortgagee physical inspections and report these as a violation of the regulatory requirements of the mortgagee and a violation of Mortgagee Letter 88-22. If mortgagee Physical Inspections are not adequate, HUD Field Offices must perform the required Physical Inspection according to Section 3 of this Chapter.

Under other circumstances (Section 1.6-5.c. and Section 3), HUD staff may elect or be required to perform physical inspections. In this inspection, although mechanical and structural problems often need to be addressed (e.g. windows, gutter/downspout, roof, HVAC), there are a significant number of other problem indicators that can be identified visually. This information, in conjunction with thorough file reviews and contacts with state/local government housing regulatory agencies, can provide significant input and direction for the Management Review.

4350.1 REV-1

When performing a physical inspection, Field Staff should be aware of the following:

- o Are landscaping and grounds properly maintained?
 - o Does the project have peeling or flaking paint? If so, is this peeling paint lead-based?
 - o Is there noticeable evidence of drug paraphernalia at the project (needles, empty "crack" or heroin packets, used hypodermic needles, spoons, etc.)?
 - o Are common areas/parking handicapped accessible?
- b. Relationship of Management Reviews to Desk Reviews of Financial Statements. Management Reviews can help loan servicers determine the cause of problems (e.g., poor rental collections, high expenses) detected in desk reviews of financial statements. Owner/Agent policies and procedures relating to these problems can then be dealt with in the Management Review process. While Management Reviews evaluate the owner's/agent's system of cash and cost controls, these reviews are not specifically designed to detect diversions of project assets. Diversions can more efficiently be detected by the Independent Public Accountant's (IPAs) audit work or the Loan Servicer's desk review of the project's annual financial statement. Nevertheless, servicers performing Management Reviews should always be alert for signs of mismanagement as well as fraud or abuse.
- C. Relationship of Management Reviews to File Reviews. Management Reviews determine whether the owner or agent has established the policies and procedures for complying with HUD's requirements for project management. These requirements may include diverse policies and procedures ranging from occupancy (e.g. preferences for selection of tenants) to financial management and tenant relationships. On-site file reviews (tenant files, tenant complaint/repair request files,
-

other project files) determine whether the policies and procedures are consistently applied and document the extent of the owner's/agent's compliance.

For example, you may wish to attempt to answer the following questions:

- o Does management respond promptly to tenant repair requests?
- o Does the project have any tenant complaints concerning discrimination?

In conjunction with these file reviews, personal interviews with interested and affected parties may provide important validation of material in the files. For example, review of project maintenance records and discussions with local housing regulatory authorities may indicate whether the project is currently in violation of local housing ordinances or whether there are outstanding local government requirements unmet by the project. Discussions with state/local government housing regulatory agencies may also provide significant data concerning possible complaints registered from prospective tenants (discrimination in housing, safety, etc.) to be used in conjunction with the total Management Review. Reviewers are encouraged to use their own discretion in deciding whether interviews with tenants and interviews/consultation with either local housing regulatory authorities and/or state/local government housing regulatory agencies will give relevant and valuable information in performing a Management Review of the project. In order to be as valid as possible, Management Reviews file reviews should be supplemented by an interview with these interested parties. Owners, agents, project staff, tenants, local housing authorities and/or the police may be considered for interview. The reviewer should verify statements made in the interviews, where possible. This verification should involve material from the file records. For example, files that indicate timeliness of completion of work orders; file review of bank statements, cancelled checks and selected paid invoices, etc. may provide verification of interview results.

4350.1 REV-1

- 6-5. FREQUENCY OF ON-SITE VISITS.
- Generally, the Field office should schedule on-site reviews in accordance with the requirements set forth in paragraphs a., b., c., d. and e. below. In determining which projects to visit and how frequently to visit them, Field Offices are encouraged to adopt the concept of "Accountability Monitoring." Those projects with the greater risk (refer to priority list in Section 1.6-5.d. and Section 3) to the Department should be reviewed prior to those with smaller or no discernible risk. Field Offices are also encouraged to develop a Management Review schedule on an annual basis, coincident with the Physical Inspection schedule, with scheduled on-site visits to projects determined to be of higher risk to the Department. The definition of risk may include such factors as the size of the mortgage, subsidy funding, indications of fraud or diversion of assets, or any other factors seen as important to the Field Office. In making a determination of the time required to conduct these on-site visit, Field Offices may limit staff time by directing the Management Review to specific project deficiencies, performing a limited Management Review. Servicers may perform limited Management Reviews according to the requirements of Section 1.6-2.b., including any additional topics, but no fewer than the required 17 questions, in cases where one negative indicator has been identified. The decision to perform a limited Management Review should take into consideration that the possibility of mismanagement is increased greatly if more than one negative indicator is shown, as discussed in Section 1.6-2.b. In those cases it may be advisable to perform a comprehensive Management Review.

Physical Inspection requirements are detailed in Section 3 of this Chapter. As required in Section 3, Field Offices must construct a list of projects scheduled for Physical Inspection and potential Management Reviews in priority order of estimated risk to the Department in order to most effectively use scarce staff resources. In constructing this priority list, Field Office staff are held accountable for their ability to monitor all serviced projects in order to protect the interests of the Department and of the tenants residing in these projects. Field Offices are then required to perform Physical Inspections on a yearly basis on projects in their multifamily inventory

identified as troubled and potentially troubled projects. Field Offices must also inspect on a yearly basis all noninsured, subsidized projects where HUD acts as the Contract Administrator. These inspections are intended to ensure that units under contract meet HQS standards, at a minimum. Field Offices are strongly encouraged to schedule Management Reviews concurrent with Physical Inspections in order to save additional travel and expense associated. In the event that no Physical Inspection is required and no other on-site visit has been scheduled, HUD Field Offices are strongly encouraged to visit each project site at least once during a 24-to 36-month period following the last Management Review. This suggestion assumes that some projects will not be inspected on a regular basis because they are deemed low-risk on the Field Office priority ranking list.

The Field Office, however, may deviate from any frequencies or triggering circumstances if the Loan Servicer and Branch Chief determine that the deviation is justified and thoroughly document the reasoning underlying that determination. A Field Office, for example, may decide that a Management Review is not needed because:

- o the project received an above-average rating on the prior review,
- o The same agent and on-site project staff are in place,
- o Recent physical inspection (e.g. required on a yearly basis for insured projects by Mortgagee Letter 88-22) and file reviews indicate that the project is well-maintained and HUD's occupancy requirements are being met, and
- o Financial statements indicate that the project is financially sound and likely to continue to be financially sound in the foreseeable future.

Before deviating from performing a Management Review, the Field Office must also consider:

- o The owner's and agent's previous records on both the project under scrutiny and other projects owned or managed by those individuals,
-

4350.1 REV-1

- o The quality, scope and results of previous on-site reviews,
- o The project's age, physical and financial condition,
- o The IPA's report on the last annual financial statement, and
- o The requirements of 4350.1, Chapter 9, (The Enforcement of Civil Rights Requirements), Sections 2 and 3. These sections detail the involvement of FHEO in the Management Review Process and possible postponement of the Management Review to include information from the FHEO review or to physically include FHEO staff in the Housing Management Review.

On subsidized projects, the loan servicer must also consider the results of the Occupancy Specialist's desk reviews of the certifications, recertifications and vouchers.

a. Management Reviews.

The Field Office should complete either a Comprehensive or Limited Management Review within the following timeframes and/or circumstances:

- o Within six months after a project commences occupancy,
 - o Following a change in project ownership/management,
 - o Prior to approving an initial workout or Flexible Subsidy/Capital Improvement Loan,
 - o When desk reviews of available documentation or the Early Warning or Risk Analysis Systems indicate that physical, financial or management problems exist and the extent or cause of the problem is not immediately apparent (troubled/potentially troubled project category),
 - o When the project is managed by an Agent whose performance deficiencies are causing problems at other projects,
-

- o Prior to granting preliminary approval of a transfer of physical assets (TPA) proposal, and
- o As necessary to monitor the owner's/agent's implementation of any required corrective actions or project improvement efforts.

b. File Reviews.

This Handbook Chapter establishes distinct and separate file reviews, Tenant File Reviews, Police Reports and Tenant Complaint Files, to be used in conjunction with the Management Review process.

Annual Financial Statements should be reviewed as required by Handbook 4370.1. The Field Office should complete these specific file reviews under the circumstances and timeframes given by the following:

- o Within six months after a subsidized project commences occupancy,
- o When desk reviews or the IPA's responses to the Internal Control Questionnaire report deficiencies in occupancy procedures, or
- o When the project is managed by an Agent whose failure to properly train and supervise staff has resulted in violations of HUD's occupancy requirements at other projects.

As a preventive measure, given sufficient staff resources, Field Offices may periodically conduct file reviews of projects not falling within the listed categories and whose risk factors are small or nonexistent. If the managing agent manages several projects within the Field Office's jurisdiction and administers most activities out of a central site, these preventive reviews may be conducted at the Agent's central office. Any resulting general findings should be shared with other affected Field Offices when a management agent manages projects across Field Office jurisdictions.

c. Physical Inspections.

Physical inspection should be completed:

4350.1 REV-1

- For insured projects, when the required mortgagee physical inspection is lacking or inadequate,
- In conjunction with the 9th or 12th month guarantee inspection,
- Prior to approving a Flexible Subsidy/Capital Improvement Loan Contract or initial workout agreement,
- When the project is identified as a high priority candidate under the priority ranking system listed below in Section 1.6-5.d. and also in Section 3 of this Chapter,
- When other servicing activities (e.g., Management Reviews, mortgagee physical inspections, excessive demands on the replacement reserve fund, high or low maintenance expenses) indicate that physical problems are developing,
- As necessary to monitor implementation of any required corrective actions or project improvement efforts from prior mortgagee physical inspections, management reviews, project MIO, etc.,
- When required by TPA procedures,
- When there is any evidence of a drug problem at the project site or in the immediate local area, as these conditions may be a precursor or direct indicator of a deteriorating project, and
- For condominiums insured under Section 234, until they become Single-Family responsibility. As a preventive tool, Field Offices should complete physical inspections every three years, if the project continues to be a Multifamily Housing responsibility.

The Field Office should only conduct physical inspections as absolutely necessary, as described under this section. Mortgagee physical

inspections (Form HUD-9822) should be used to the maximum extent possible to support the Field Office's loan servicing efforts.

- d. The following priority list should be utilized by Field Offices in scheduling for Physical inspections and in considering whether to consider whether to perform a Management Review and what level of review to perform. Appendix 3 provides indicators for troubled and potentially troubled projects for further use in making this determination.

FIGURE 2
MANAGEMENT REVIEW/PHYSICAL INSPECTION PRIORITY RANKING

i.	Insured assisted troubled
ii.	HUD-Held assisted troubled
iii.	Non-insured assisted troubled
iv.	Insured unassisted troubled
v.	HUD-Held unassisted troubled
vi.	Insured assisted potentially troubled
vii.	HUD-Held assisted potentially troubled
viii.	Non-insured assisted potentially troubled
ix.	Insured unassisted potentially troubled
x.	HUD-Held unassisted potentially troubled
xi.	Insured assisted
xii.	HUD-Held assisted
xiii.	Non-insured assisted
xiv.	Insured unassisted
xv.	HUD-Held unassisted

"Assisted" properties include those that are insured and non-insured, but are receiving mortgage assistance (221(d)(3) BMIR, 236 Interest Reduction Payments, direct loan) and/or rental assistance (Section 8, Rent Supplement and Rental Assistance Payments).

- e. Relationship of On-site reviews to requests for HUD assistance.

In all transactions concerning any project where additional HUD assistance is requested (for example, Flexible Subsidy, Capital Improvement Loan Program, Section 8 Loan Management Set-Aside, Section 241 Equity Take-out Loan, Work Outs, Partial Payment of Claims), or approvals are sought (such as TPAs), the Field Office shall:

4350.1 REV-1

- i. Ensure that the physical condition of the property is satisfactory or will be returned to satisfactory condition upon delivery of such requested assistance or approvals, and that all project services and management are reliably and competently delivered;
- ii. Ensure that, based on Field Office records, the project operation is generally free of significant or repetitive resident complaints or that the cause of the complaint would be rectified by such assistance; and
- iii. Ensure that, where a problem exists, HUD does not provide or negotiate any transactions for assistance until the owner:
 - o Submits a plan to correct and remedy any deficiencies documented by the Department, and
 - o Certifies and documents that he/she has taken steps to secure funding from all possible sources.

The owner's plan must constitute a final solution to the problems and to the deficiencies.

6-6. DETERMINING THE SCOPE OF THE ON-SITE REVIEW.
The Field Office should tailor all on-site reviews to:

- o The physical and financial conditions of the project,
- o The past performance of the management agent in place,
- o Any other purposes for conducting the review, also stated in Section 1.6-2.c. of this Chapter, including:

Status of project on the priority ranking list,
Results of previous on-site reviews,
Results from recent FHEO reviews, and
Review of local police reports, if available.

Field Offices are cautioned that, in determining the scope of the review to respond to items on the Form [HUD-9834](#), a minimum of all 17 shaded areas must be completed. This review constitutes a Limited Management Review, as defined in Section 1.6-2.b. of this Chapter 6.

- a. Examples for adapting the Management Review.
 - i. Example #1: Unfamiliar Agent
If the purpose of the review is to assess the performance of an agent with whom the Field Office is not familiar, the Field Office should perform a Comprehensive Management Review and examine all management tasks listed on the [HUD-9834](#), Management Reviews of Multifamily Projects. This form is provided in Appendix 1 and more detailed instructions are given in Section 2 of Chapter 6.
 - ii. Example #2: Familiar Agent
If the Field Office is already familiar with the Agent's performance, either at this or at other projects, the Field Office may perform a Limited Management Review and look at a sample of the more important management tasks (i.e. cost controls, budgeting, preventive maintenance, tenant screening, application of preferences and tenant selection, training and supervision of staff). If the Field Office has seen problems with some aspects of the agent's performance, the focus of the limited review may be altered to include more of these aspects or a comprehensive Management Review should be done (see Section 1.6-2.b.). NOTE: The Limited Management Review must not include fewer than the shaded areas shown on the Form [HUD-9834](#).
 - iii. Example #3: Cash Flow Problems
If the purpose of the review is to determine the cause of cash flow problems, the Field Office should identify possible causes of the problems and look at management tasks related to those problems or causes. Several examples of items to be examined or considered include:

- o If operating expenses are higher than those of comparable projects, review some of the cancelled checks and paid invoices relating to the expense categories that appear excessive. Also, check the project's cost control procedures (e.g., bulk purchasing, taking advantage of discounts, contracting procedures such as comparing prices, preparing and monitoring budgets),
 - o If the vacancy rate is higher than at comparable projects, assess "curb appeal," review marketing procedures and procedures for readying units for occupancy following move-out,
 - o If turnover is high, evaluate tenant screening, the effect of competition (including state agency and conventional properties), management's responsiveness to tenant complaints and repair requests, and quality of maintenance, etc., and
 - o If accounts receivable are high, evaluate tenant selection and screening procedures, and review procedures for collecting rents, identifying and tracking delinquencies, following up on delinquent accounts and evicting delinquent tenants.
- iv. Example #4: Excessive Capital Replacement Costs If requests for withdrawal of replacement reserve funds show more frequent than usual replacement of appliances or equipment, the Field Office should consider conducting a test of the physical inventory, examining controls over the property and taking a sample of the maintenance records on equipment and appliances. Field Offices should also examine the adequacy of tenant training in the use and care of appliances, carpets, drapes, facilities, etc., the adequacy of preventive maintenance procedures and the quality of goods purchased.

Additionally, the reviewer should be alert for missing items and evidence of tenant or owner/agent unauthorized use of project funds or efforts to fraudulently obtain and use funds.

SECTION 2. MANAGEMENT REVIEW FORM

6-7. MANAGEMENT REVIEW FORM USE AND PURPOSE.

- a. Management Reviews and Use of Form [HUD-9834](#)
Field Office staff shall use Form [HUD-9834](#), management Reviews of Multifamily Projects, to complete these reviews.
- b. Purpose of the Form [HUD-9834](#)
The Form [HUD-9834](#) has been designed to:
 - i. Identify the type and quality of management services that the Department expects;
 - ii. Collect sufficient information to document areas of non-performance and provide documentation for removing project manager, when necessary, and enable supervisory Field Office staff to evaluate the Loan Specialist's review conclusion;
 - iii. Assist Field Office staff in identifying the causes of project problems and requiring project owners and agents to remedy these problems;
 - iv. Standardize report findings and performance evaluations for future input to MIPS or other automated data systems.

6-8. USE OF REVIEW FORM.

- a. Instructions to Field Staff on Form [HUD-9834](#), Management Reviews of Multifamily Projects.
Field Office staff shall use this form to summarize and report their findings and to convey the review findings and recommendations to the owner/agent. The form lists 45 management tasks, six category ratings and one overall Management Operation rating. The six major categories included on the Form [HUD-9834](#) are:

- (A) Maintenance and Security;
- (B) Financial Management;
- (C) Leasing and Occupancy;
- (D) Tenant-Management Relations;
- (E) Drug-Free Housing Policy; and
- (F) General Management Practices.

For each of the 45 management tasks, the Loan Specialist must determine whether existing conditions and procedures are acceptable or whether corrective action is needed. A statement of the deficiencies and, when possible, recommended corrective actions must be entered on page 3 of the Form [HUD-9834](#).

The questions in Form [HUD-9834](#) walk the Loan Servicer through the analysis that is needed to identify problem areas, evaluate performance and complete the Summary Page of the Form [HUD-9834](#). Questions have been worded so that a "no" answer will indicate a possible problem area. Supervisory staff need only address areas where negative answers were obtained. If some of the questions have been covered in the Audit Compliance and Internal Control Questionnaire portion of the IPA audit, Appendix 2 to Handbook IG 4372.1, the findings of that audit should be presented at the appropriate points in the Form [HUD-9834](#), and no further analysis of these areas is required. If, however, the auditor's unqualified certification is not available, additional review will be necessary to respond to those items.

The Loan Specialist should assess the adequacy and effectiveness of the owner's and agent's operations for each of the final six category summary ratings,

- I. Maintenance and Security;
- II. Financial Management;
- III. Leasing and Occupancy;
- IV. Tenant-Management Relations,
- V. Drug-Free Housing Policy; and
- VI. General Management Practices.

Further guidance on deciding between "Superior", "Satisfactory", "Below Average", and

"Unsatisfactory" category and Overall Management Category (Section VII.) evaluations is provided in this section, specifically Section 2.6-11., in order to promote consistent evaluations between categories and among Field Offices.

- b. Guidance in Using Form [HUD-9834](#)
Additional, more specific, guidance for Field Staff in completing the review are included in this Section and at the beginning of the Form [HUD-9834](#) and within each section of Form [HUD-9834](#). Loan Management staff may consult with technical experts (e.g. EMAD staff) to assist in the review, when necessary.
- c. Distribution
Instructions for distribution of the Summary and Addendum sheets (Pages 2 and 3) of the Form [HUD-9834](#) are included on the cover sheet (Page 1) of the form.

6-9. SPECIFIC GUIDANCE FOR FORM [HUD-9834](#)

QUESTION	INSTRUCTION
# 7.a.	If the managing agent has a list of contractors with whom it has contracts or other established purchasing arrangements, please answer Yes. If the manager maintains a list of vendors only for purposes of competition, answer No to this question and make a note in the Remarks Section to refer to the answer for Question 7.c.
# 7.c.	If the managing agent maintains a source list from which competitive purchases are made, please answer Yes to this question. Also respond Yes if there is any other evidence that competitive pricing was accomplished (e.g. Records of telephone pricing using the "Yellow Pages").
#29-32	HUD Staff are encouraged to interview a randomly chosen sample of tenants when performing a Management Review. This method, especially for Question #32, is an acceptable and desirable technique for gathering information. A rough "rule of thumb" for a minimum recommended sample would be approximately 10% of the number of units in the project.

Field Offices should ensure that owners and agents give residents proper consideration at all times. File reviews and tenant interviews should indicate that comments received from residents are considered and that residents' problems are resolved as efficiently and effectively as possible.

Areas such as rent increases and major capital additions may require a tenant comment period (see 24 CFR Part 245). Field Offices must ensure that this requirement is met.

6-10. CHANGES IN POLICIES AND PROCEDURES: FORM [HUD-9834](#)

The Form [HUD-9834](#), Management Reviews of Multifamily Projects, now lists several new categories to be considered. Departmental policy changes affecting elements in the Form [HUD-9834](#) must be considered. Future policy guidance may also impact on the Management Review process and the Form [HUD-9834](#) procedures. Recent policy or procedural changes include:

SUBJECT AREA	EFFECTIVE DATE	DISSEMINATED AS:
Pets	12/1/86 (51 FR 43296)	24 CFR Part 243
Lead-Based Paint	3/2/87 (52 FR 9827)	Final Rule
- with Amendments	6/6/88 (53 FR 20790)	Final Rule
Fair Housing Review	6/3/88	Handbook 4350.1, Chapter 9, dated 6/88
Tenant Preferences	9/2/88	Handbook 4350.3, Chapter 3, dated 9/88
Processing Budgeted Rent Increases	3/31/89	Handbook 4350.1, Chapter 7, dated 3/89
Program Enforcement	1/91	Handbook 4350.1, Chapter 8, dated 1/91

6-11. MANAGEMENT REVIEW CATEGORY RATINGS

The following descriptions provide guidance to servicers in rating the six specific categories (Questions A.I. through F.VI.) and the Overall Management Operation (Question VII.) evaluated by the Form [HUD-9834](#). Please use these descriptions as a tool in making decisions concerning which rating to give in each category.

- a. Superior Rating.
Management's performance should be rated superior if:
- o Management has established policies and procedures which are successful in carrying out the objectives of HUD housing programs (i.e., provision of well-maintained housing at the lowest possible rents and proper use and concern for Federal subsidy and insurance funds);
 - o Procedures are strictly adhered to and result, with very few exceptions, in compliance with the regulatory agreement, subsidy and mortgage relief contracts, and management plans and agreements; and
 - o The incidence of error disclosed in the review is minimal and no major adverse findings are made.
- b. Satisfactory Rating.
Management's performance should be rated Satisfactory if:
- o Management is successfully carrying out the objectives of HUD programs;
 - o Procedures have been established but not always adequate to prevent errors from occurring; and
 - o The Owner, Agent or their employees for one reason or another do not always follow established procedures or the findings are such that, with minor adjustments to existing procedures or additional training, the Owner/Agent should be able to cure the deficiencies. In such cases, a satisfactory rating should be given only if the Owner/Agent is willing to make the necessary adjustments and complete the necessary training.
- c. Below Average Rating.
Management should be rated Below Average if:
- o Its policies and procedures are ineffective or inappropriate for the project;

- o The policies and procedures do not meet the requirements of the regulatory agreement, management agreement or subsidy contracts;
- o Weaknesses in procedures result in frequent failures to comply with published HUD instructions; and
- o The Owner/Agent would need significant changes to its existing procedures or the owner/agent or on-site employees would need significant amounts of training to cure the deficiencies.

d. Unsatisfactory Ratings.
Management's performance should be rated unsatisfactory if:

- o Management's actions or failure to act have placed the Secretary's interest in jeopardy or frustrated achievement of our housing objectives;
- o If there are major adverse findings; or
- o If the policies and procedures are ineffective or lacking to the extent that the owner/agent frequently, and often seriously, fails to comply with HUD's regulations and published instructions.

Examples of major adverse findings include, but are not limited to: willful failure to maintain the property; unauthorized distributions; willful failure to remit payments to the note holder; implementation of unauthorized rent increases; failure to recertify tenants; fraudulent recertifications by the Owner/Agent; and failure to comply with equal housing laws. As a part of this evaluation, the reviewer should consider whether the Owner/Agent has the capabilities and/or desire to implement the necessary changes to cure the deficiencies. An Owner/Agent who receives an overall unsatisfactory rating would normally be removed or prohibited from participating in HUD programs.

- e. Rating of Overall Management Operation.
Category VII. of the Management Review Report provides space for an overall rating of the agent's performance. This rating should be based upon consideration of the action codes awarded on individual line items, the seriousness of the findings and the ratings assigned Categories A.I., B.II., C.III., D.IV., E.V. and F.VI.

There is no numerical formula for converting action codes and categorical ratings into an overall rating. The servicer must develop the overall rating by assessing the impact of various management deficiencies on a specific project. Generally, the categories of Maintenance and Security, Financial Management, and Leasing and occupancy on subsidized projects have the greatest impact on the project. Therefore, if the lowest categorical rating given on the Management Review report is in one of these categories, that categorical rating would normally be the overall rating. If Tenant/Management Relations or General Management Practices receive a lower categorical rating, the overall rating would not normally be greater than one rating higher than the lowest categorical rating given. When assigning ratings, the servicer must recognize that the overall rating may impact the Previous Participation Clearance Process.

Finally, in assessing the management operation, the Loan Specialist must consider the condition of the project at the time the owner/agent assumed responsibility and how long that owner/agent has been responsible for project operations. For example, even though a Loan Specialist may determine in Question #18 that tenant accounts receivable are excessive, management's procedure for collecting delinquent accounts could be satisfactory. It may be that the project manager has only recently assumed responsibility for the project and that rent delinquencies had accumulated prior to the effective date of the management contract. Field Office staff must use professional judgement and evaluate all available information - e.g., responses to questions, observations, materials in project files, etc.

- 6-12. NOTIFICATION TO OWNERS/MANAGERS.
The Field Office, upon completion of the Management Review, must conduct a close-out briefing at the project and then must send a written report to the owner. Reports for reviews carried out by HUD staff will be completed within thirty (30) days from the completion of the field work. Reports for contractor reviews will be completed within the contracted timeframe. A copy will be sent to the project managing agent and/or contact identified by the owner, and to the mortgagee for projects with insured mortgages, within two (2) working days of the completion of the report.
- 6-13. OWNER/MANAGER ACTIONS UPON RECEIPT OF MANAGEMENT REVIEW.
Owners must provide the Field Office with a plan for correction of any noted deficiencies within thirty (30) days of the date of notification. Such response will not be delayed by the owner's option to appeal. The correction of valid deficiencies which were not appealed shall not be delayed during an appeal. The plan may utilize the MIO plan format.
- 6-14. APPEALS PROCEDURES FOR OWNERS/AGENTS
Owners/Agents of projects receiving "Below Average" or "Unsatisfactory" evaluations on any specific category or on the Overall rating on the Form [HUD-9834](#) Summary Page may appeal their ratings in the sequence given in this Section 2.6-14.
- a. Initial Appeal to Field Office
- i. The written appeal must be sent to the Field Office performing the Management Review and postmarked within 30 days of the date of the letter transmitting the Form [HUD-9834](#) rating.
 - ii. The appeal letter must explain the factual basis for a change in rating, with sufficient specific examples provided to allow the rater to evaluate the information.
 - iii. The Field Office Loan Management Branch handling the appeal is responsible for evaluating the additional information through

in disagreement.

- iv. The initial appeal decision must be approved and transmitted by mail to the owner/agent by the Field Office Housing Management Division Director within a 45 day period following receipt of the appeal.

b. Final Appeal

- i. If the owner does not agree with the initial appeal decision, the owner/agent may submit a final appeal to the Director, Regional Office of Housing.
- ii. The final appeal must be in writing and postmarked within 15 days of the transmittal date of the initial appeal decision letter from the Field Office Housing management Division Director.
- iii. The Regional Office will be responsible for obtaining all information from the Field Office performing the original Management Review and initial appeal determination.
- iv. The owner/agent may request a meeting with the Regional Director of Housing (or, at the discretion of the Regional Director of Housing, a representative) to present verbal arguments, but such a meeting must be requested and completed during a 30-day period following the transmittal date of the initial appeal decision letter.
- v. A decision on the final appeal must be approved and transmitted to the owner by the Regional Director of Housing within 45 days of the receipt of the final appeal letter.

- c. Decisions rendered by the Regional Director of Housing will be final and will not be subject to further appeal.

6-15. MONITORING.
HUD staff must ensure that owners are carrying out the required corrective actions. If a monitoring system is not in place, the Field Office shall establish a

follow-up and reporting system which monitors the actions taken by the owner to cure existing deficiencies.

As long as the deficiencies are being corrected in a timely and professional manner, the monitoring shall continue by the Field Office. If new deficiencies are revealed as a result of routine monitoring or as a result of a subsequent review of operations then the Field Office will repeat all steps necessary to assure owner compliance. If progress is being made and the management agent is keeping the agreed timeframes, then the report should reflect the progress even if the overall project evaluation continues to be less than satisfactory.

6-16. ACTIONS TO BE TAKEN BY FIELD OFFICES IN THE EVENT OF OWNER NONCOMPLIANCE, NONRESPONSE OR NONPERFORMANCE OF ACTION PLAN.

Field Office staff shall notify the owner in the case of noncompliance with the plan. The owner must take remedial action immediately upon receipt of notification, and must provide an explanation of any noncompliance. If the noncompliance is caused by the management entity, then sanctions against the management entity must be undertaken. These may include:

- o Requiring the owner to replace the management agent;
- o Filing a report under the form HUD-2530, Previous Participation Certificate process;
- o Instituting limited denial of participation or other administrative sanctions;
- o Applying civil money penalties as outlined in 24 CFR Part 30;
- o Taking legal action, such as filing a lawsuit to address a specific infraction.

Also, the owner must develop and provide to the Field Office proposed revisions to the plan of corrections within ten (10) days of the notification. The Field Office will analyze any modifications to determine their feasibility and their effect on the continued

viability of the plan. For properties with insured and HUD-held mortgages, if the Field Office determines that a good faith effort is not being made to correct deficiencies noted in the management review report, if a plan is not received, or if the plan, as revised, is no longer workable, then the Field Office should pursue a declaration of default, under either the waste provision of the mortgage or under the Regulatory Agreement. Field Offices must follow the specific determination, documentation, notification, and assignment/foreclosure procedures outlined in Section 3.6-26. of this Handbook.

SECTION 3. PHYSICAL INSPECTIONS

The Department is committed to aggressively monitor and enforce project maintenance, upkeep and repairs to protect the Government's insurance investment. This section outlines procedures for a comprehensive physical inspection program for HUD's Multifamily Insured, HUD-Held, Direct Loan, and Assisted portfolio.

The physical inspection program includes five major components: (1) the identification and yearly inspection of troubled and potentially troubled projects; (2) the yearly inspection of non-insured assisted housing where HUD is the Contract Administrator and has primary responsibility for physical inspections; (3) increased monitoring of the mortgagee physical inspection process; (4) the requirement of current physical inspections prior to the approval of various actions; and (5) the encouraging of all HUD staff, when on official HUD travel status and time permits and when in the proximity of HUD-held, direct loan, insured, or assisted housing projects, to become involved in drive-by/walk-through reviews, which might indicate that further inspection is required. These five components are described in the following sections.

- 6-17. PHYSICAL INSPECTION PRIORITY SYSTEM
- Each Field Office must maintain a list, within their respective jurisdictions, of properties identified as troubled or potentially troubled. Field Offices should use indicators such as Management Review reports, mortgagee physical inspection reports, and resident complaints to help in identification of these projects. The list of indicators in Section 1.6-2.c. and Appendix 3 of this chapter provides further guidance on the elements to be considered in determining whether a project might be considered troubled or potentially troubled.

Each Field Office must have developed a schedule for the inspection of all troubled or potentially troubled multifamily projects in its portfolio, with each such project receiving a Physical Inspection within a 12-month period of time from the last Field Office Physical Inspection.

- a. Priority Listing and Resource Allocation.
The priority list provided in this Section 3.6-17.a. should be utilized by Field Offices in scheduling for physical inspections. "Assisted" properties include those that are insured and non-insured, but are receiving mortgage assistance (221(d)(3) BMIR, 236 Interest Reduction Payments, direct loan) and/or rental assistance (Section 8, Rent Supplement and Rental Assistance Payments).

Insured assisted troubled projects will receive inspections and remedial attention first. Other categories of projects will follow. Even though assisted projects will be inspected first, all housing under HUD's regulatory control, including market rate properties, should have been scheduled and inspected at least once prior as a check on the quality of mortgagee Physical Inspections. Non-insured assisted projects where HUD is not the Contract Administrator or where HUD does not, according to regulations, have primary responsibility for physical inspections, should continue to be inspected by the appropriate entity, such as state agency, FmHA, or a PHA.

FIGURE 3
PHYSICAL INSPECTION PRIORITY RANKING

- | | |
|-------|---|
| i. | Insured assisted troubled |
| ii. | HUD-Held assisted troubled |
| iii. | Non-insured assisted troubled |
| iv. | Insured unassisted troubled |
| v. | HUD-Held unassisted troubled |
| vi. | Insured assisted potentially troubled |
| vii. | HUD-Held assisted potentially troubled |
| viii. | Non-insured assisted potentially troubled |
| ix. | Insured unassisted potentially troubled |
| x. | HUD-Held unassisted potentially troubled |
| xi. | Insured assisted |

- xii. HUD-Held assisted
- xiii. Non-insured assisted
- xiv. Insured unassisted
- xv. HUD-Held unassisted

The schedule for inspection of troubled or potentially troubled projects and noninsured, assisted projects where HUD is the Contract Administrator, must contain a resource utilization strategy for use of Field Office staff.

- b. Field Offices must establish a tracking and quality control system for all Physical Inspections, including those accomplished by mortgagees.

6-18. YEARLY INSPECTION REQUIREMENT FOR TROUBLED, POTENTIALLY TROUBLED, AND NONINSURED, ASSISTED PROJECTS WHERE HUD IS THE CONTRACT ADMINISTRATOR

Field Office staff shall schedule their time in such a way as to complete, within a year from the previous inspection, physical inspections on 100% of the insured projects identified as troubled or potentially troubled and on 100% of other noninsured assisted projects where HUD is the Contract Administrator. Field Offices must also be assured of the adequacy of mortgagee Physical Inspections for the remaining portion of the insured and HUD-held portfolio which was not inspected by HUD staff during the previous year.

6-19. INCREASED EMPHASIS ON QUALITY OF MORTGAGEE PHYSICAL INSPECTION

- a. Mortgagee Physical Inspection Requirements.
By the terms of the Mortgagee's Certificate filed at the time of closing the mortgage transaction, and by the requirements of Mortgagee Letter 88-22, the mortgagee is bound (so long as the mortgage is HUD-Insured) to ascertain the continued physical viability of the project. According to Mortgagee Letter 88-22, mortgagees must inspect each insured property at least once in each calendar year. This ensures that the project is physically well-maintained and providing decent, safe and sanitary housing to tenants. Given the direct relationship between a poorly-run, poorly-maintained project and default, the insurance fund is better protected and HUD's interests safeguarded when the mortgagee fulfills its physical inspection requirements. The mortgagee is required to send

copies of inspection results on Form HUD-9822, Physical Inspection Report, to mortgagor, agent and local Field Office.

It is the responsibility of the Loan Management Branch Chief to secure copies of such reports and see that they are reviewed and evaluated by the Loan Management Branch. This review is part of normal loan management activities and should be done in preparation for a potential Management Review.

- b. Field Offices must inspect only the portion of the portfolio necessary to monitor the reliability of these mortgagee inspections unless such Physical Inspections are those performed by the Field Office, as required by this Chapter, on projects that have been identified as troubled or potentially troubled.
- c. If mortgagee Physical Inspections are inadequate, incomplete or missing Field Offices must perform the inspections and take remedial actions against the mortgagee, as described in the following Section 3.6-19.d. of this Chapter 6.
- d. HUD Remedies for Mortgagee Noncompliance
If the required physical inspection is not performed by the mortgagee, is incorrect or inadequate, the Housing Division Director shall have two potential remedies.

First, the Housing Division Director shall inform the mortgagee that in the event of a default and subsequent claim for mortgage insurance benefits, the amount of insurance benefits may be reduced by any diminution in the value of the property due to the mortgagee's failure to make an annual inspection of the property or to notify HUD of any deficiencies in the physical condition of the property.

Second, The Housing Division Director shall refer information on the mortgagee and the physical inspection nonperformance to the HUD Mortgagee

Review Board (MRB) for potential action by the MRB.

-
- 6-20. CURRENT PHYSICAL INSPECTION REQUIRED PRIOR TO APPROVAL OF FUNDING ACTIONS
- Field Offices must ensure that a physical inspection has been carried out prior to the approval of actions with funding components, such as additional subsidy approvals and workouts. This inspection requirement is not to be bypassed unless:
- o A Physical Inspection performed in conformance with these requirements has been completed within the last year, or
 - o A Physical inspection in conformance with this requirement has not been performed within the last year, but project operations will be imperiled without approval of the requested assistance.
- 6-21. ENCOURAGING DRIVE-BY/WALK-THROUGH REVIEWS
- When HUD staff from all programs are on official HUD travel for any reason, if time permits, they should try to drive by any HUD assisted and insured projects located nearby their travel route or destination. Their objective will be to observe informally the physical condition of the project with a quick walk through or drive-by to see whether the project seems to be adequately maintained, or whether it may require a formal inspection. This is a sound management practice that will make prudent use of scarce travel funds. The Regional Administrator and Field Office Manager are responsible for ensuring the adoption of this practice. Reports by travelers to the Loan Management Branch Chief may be made by telephone, informal cc:Mail messages, or informal staff "working notes." Since relaying of observations is informal and only gross (significant) problems are expected to be noted, no special training of staff is necessary. Travelers should be provided with a list of projects to be visited during official HUD travel and should try to provide a report to the LM Branch Chief within five (5) working days of the completion of travel.
- 6-22. OTHER REQUIREMENTS FOR FIELD OFFICE PHYSICAL INSPECTIONS.
- a. Physical inspection should be completed by Field Offices, as stated in Section 1.6-5.c., when the following conditions exist:
 - o In conjunction with the 9th or 12th month guarantee inspection,
-

4350.1 REV-1

- o Prior to approving a Flexible Subsidy/Capital Improvement Loan Contract or initial workout agreement,
- o When the project is identified as a high priority candidate under the priority ranking system listed in this Section 3.6-17. of this Chapter 6,
- o When other servicing activities (e.g., Management Reviews, mortgagee inspections, excessive demands on the replacement reserve fund, high or low maintenance expenses) indicate that physical problems are developing,
- o In order to monitor implementation of any required corrective actions or project improvement efforts,
- o When required by TPA procedures.
- o When there is any evidence of a drug problem at the project site or in the immediate local area.
- o For condominiums insured under Section 234, until they become Single-Family responsibility. As a preventive tool, Field Offices should perform physical inspections every three years, if the project continues to be a Multifamily Housing responsibility.
- o When the required mortgagee physical inspection is nonexistent, incomplete or inadequate.

6-23. REQUIREMENT TO DISCUSS FINDINGS WITH OWNER/AGENT AND DOCUMENTATION OF PHYSICAL INSPECTION FINDINGS

- a. Close-out Meeting Requirement.
Following the inspection of the project, the servicer or contractor must meet with the site manager or owner/agent representative to discuss in general terms the observations made at the project. Through this "close out" meeting, owners should be informed of the major areas of concern
-

so they can begin to develop strategies for addressing the problems. Field Office staff should stress at the meeting that the areas of concern identified are not necessarily all-inclusive. The final physical inspection report may include additional findings of deficiency based on the analysis of the overall inspection.

- b. **Physical Inspection Report.**
Each physical inspection will be documented in writing with detailed deficiency explanations, recommended or required actions and time frames, and conclusions. The prescribed format for this documentation will be Form HUD-9822, "Physical Inspection Report." The report must be signed and dated, and must specify the expected actions. The report should be completed within thirty (30) days of the completion of the field work.

Inspectors will record all deficiencies noted at the project (including the location of the deficiency). Detailed descriptions of deficiencies and locations will be retained in the project files, while the report to the owner may be summarized. For example, the notes of the inspector may show dozens of instances of broken windows. The report, however, may state that throughout the project broken windows were observed and require the owner's plan to repair or replace all broken windows. The cost estimate will be based on a composite of the observed deficiencies (e.g. 45 window panes @ \$10). In addition, where practicable, photographs will be taken and provided as part of the Form HUD-9822 documentation. Care should be taken to assure that photos are cross referenced to location and provide a description of the deficiency. Photos should be used to capture both good and bad conditions.

- c. The Field Office must send the completed physical inspection report to the owner within two (2) working days of the completion of the report by HUD staff or contractors. A copy of the report must also be sent to the managing agent and/or other contact identified by the owner, and to the mortgagee for properties with insured mortgages. It is not required that the Field Office send any
-

4350.1 REV-1

photos with the report unless such pictures are specifically referenced in the report. Photos are primarily for use by Field Offices.

6-24. PHYSICAL INSPECTION DEFICIENCY PROCEDURES

- a. Field Office determines nature of deficiency. Field Offices must make an initial determination of the nature of deficiencies found by Physical Inspection. A deficiency should be considered either "serious" or "non-serious," and Field Offices must develop specific criteria for application to the physical inspection findings. Field Offices may use criteria such as whether the repair need was judged as "immediate," the health and safety threat of the repair need, and the cost of the required corrections. Field Counsel should review the documentation to make an initial determination as to whether "waste" (See Default Procedure under Section 3.6-26.) is present or if a failure to maintain the property in good repair has been displayed. Field Counsel should provide the program office with guidance on the documentation. Both the guidance and the documentation must be retained. Appendix 4 provides further instructions on the Field Counsel review process.
- b. Recruited actions by owner/agent. Where serious deficiencies are identified in the Physical Inspection report, owners must:
 - i) Meet with the Field Office staff within ten (10) working days from the date of issuance of the report to discuss the deficiencies identified during the inspection;
 - ii) Provide a written report at the Field Office meeting on all actions taken since the report was issued to correct the deficiencies noted; and
 - iii) Provide a written plan detailing how and when the remaining deficiencies will be corrected within twenty (20) working days of the meeting.

The Management Improvement and Operating (MIO) Plan format, including a budget identifying the source of funds, may be used to provide the plan. For deficiencies which are not identified as serious, owners are not required to meet with the Field Office. However, in these cases, owners/agents must submit a plan within thirty (30) calendar days of the date of receipt of the report, and are subject to all of the monitoring and enforcement actions outlined in this Notice.

6-25. MONITORING CORRECTIVE ACTIONS.

- a. Develop/Implement tracking system.
If a monitoring system is not in place, each Field office will develop a system to monitor planned and completed corrections. The Early Warning System, when implemented, may aid in the tracking of corrective plans. where serious deficiencies were identified during the physical inspection, the Field Office shall schedule a follow-up inspection within thirty (30) days or less of the meeting to assure satisfactory completion of all corrections that the owner indicated were completed from the date of the inspection through the meeting. Follow up inspections on completed tasks may be performed by permanent staff or by contract inspectors (for projects with insured and HUD-held mortgages only). All follow-up inspections must be documented either through a memorandum to the file, or on a Form HUD-9822, clearly marked to show that the inspection is a follow-up. If the owner/managing agent has taken steps to correct the findings and has kept to the original completion dates such compliance should be noted even if the overall project rating continues to be less than satisfactory.
 - b. Tracking and Review of Corrective Action Plans.
Corrective plans for insured projects, including those submitted for non-serious deficiencies, must be formalized and trackable, and monitored in the Field Offices. The plans should be reviewed by Field Counsel as specified in Appendix 4. As Part I of the Appendix explains, the role of the Field Counsel in reviewing the designation of "serious" deficiencies and the corrective plans is to advise program staff on the legal issues involved in these actions. For HUD-held projects, corrective plans will be included in and made part of a
-

4350.1 REV-1

workout. If the owner refuses to cooperate (i.e. fails to produce a plan to correct the deficiencies or will not modify the workout), then enforcement actions by the Field Office in conformance with this Handbook Chapter are required.

It is not acceptable for an owner to respond that the cash flow generated by the project is not enough to make the corrections. Field Offices should expect to receive well thought-out plans specifying the level and source of funds necessary to bring the physical plan to an acceptable condition. Where an owner is requesting increased HUD funding (such as additional subsidized units or Flexible Subsidy) to pay for all or part of the required repairs, he/she must present a certification and supportive documentation that he/she has made every effort to secure funding from all possible funding sources. Field Offices shall not approve plans unless they provide for the final resolution of the deficiencies.

- c. Initial actions to be taken in event of noncompliance.

Field Office staff shall notify the owner in the case of noncompliance with the plan. The owner must take remedial action immediately upon receipt of notification, and must provide an explanation of any noncompliance. Also, the owner must develop and provide to the Field Office proposed revisions to the plan of corrections. The Field Office will analyze any suggested modifications to determine their feasibility and their effect on the continued viability of the plan. If the Field Office determines that a good faith effort is not being made to bring the project into acceptable condition or if the plan, as revised, is no longer feasible, then enforcement actions described in Section 3.6-26. should be taken.

- 6-26. ACTIONS BY FIELD OFFICE NECESSITATED BY NONCOMPLIANCE, NONRESPONSE OR NONPERFORMANCE BY OWNERS OF PROJECTS WITH HUD-INSURED OR HUD-HELD MORTGAGES.
This section provides a list of sanctions to be used if an owner of a HUD-Insured or HUD-Held mortgage fails to:

- o Meet as requested with the Field Office,
 - o Cooperate with the Department;
 - o Provide the requested reasonable corrective action plan;
 - o Perform the agreed upon corrective actions contained in the approved plan; or
 - o Make appropriate revisions to a plan which has not been carried out according to the agreed upon timetable; then the Field office must determine whether to recommend a declaration of default under the waste provision of the mortgage, or to recommend a declaration of default under the Regulatory Agreement, or to initiate litigation against the owner.
 - a. Imposition of Sanctions.
The following are administrative actions which may be used to enforce compliance with the Regulatory Agreement. One or all of these sanctions may be imposed, in accordance with existing HUD requirements, until the needed corrections are accomplished:
 - o Replacement of managing agent with qualified manager.
 - o Denial of rent increases.
 - o Denial of releases from Reserve for Replacements.
 - o Denial of requests for deferment of principal payments or forbearance agreements.
 - o Denial of releases from residual receipts.
 - o Recommendation to Director, Office of Multifamily Housing Management, Headquarters, to stop rent supplement, interest reduction, or Section 8 payments.
 - o Recommendation to the Director, Office of Multifamily Housing Management, Headquarters, to declare a technical default under the Regulatory Agreement.
-

4350.1 REV-1

b. Declaring a Technical Default.

If the owner has failed to perform the corrective action plan and the physical condition of the property has deteriorated to an unsatisfactory level, the Field Office must determine whether the administrative record supports a finding of violation of the waste provision of the mortgage or a declaration of default under the Regulatory Agreement. The Field Counsel should provide guidance on the legal issues and necessary documentation associated with either determination. Appendix 4 includes a discussion of the role of the Field Office Counsel in developing a recommendation and on the criteria which should be used in the determination.

If the Field Office Manager determines that a declaration of default under either the mortgage or the Regulatory Agreement is appropriate, he/she must recommend a declaration of default to the Regional Administrator. The Regional Administrator or his/her designee shall have the authority to approve or disapprove the Field office determination.

If the Regional Administrator accepts the Field office recommendation, the Field Office must notify the owner of the intended action by certified mail with return receipt requested, and must send a copy of the notification to the managing agent. The notification must be reviewed by Regional Counsel and signed by the Regional Administrator before being sent to the owner. The Field Office must inform owners in the notification that they will be given thirty (30) calendar days to show sufficient cause why the default should not be declared, or to otherwise provide the plan, or feasible revised plan, or carry out the previously approved plan of action. The Director of Housing Management may extend the time frame for specific cause on a case-by-case basis. He/she must document such cause for the record.

If the owner does not satisfactorily show cause or comply with the Field office and Regional Administrator's requests regarding corrective actions within thirty days (or within the approved

time frame), the default declaration should proceed with a request to the mortgagee to accelerate the principal balance of the mortgage. (See Appendix 4, Part V.) This letter should be prepared by the Regional Counsel and concurred on by the field and regional program offices. For declarations of default under the waste provision of the mortgage, the letter should require that, under the authority provided the Secretary contained in 24 CFR Part 207.257, the mortgagee declare a Covenant Default and accelerate the principal balance of the mortgage. For projects with HUD-held mortgages, the Director of Housing Management must request the Office of Mortgage Insurance Accounting and Servicing to accelerate the principal balance of the mortgage and to declare the balance immediately due and payable.

After the mortgagee has prepared the election to assign and the processing of the claim is under way (or MIAS has completed the necessary steps for HUD-held mortgages), the Regional Counsel, upon instruction by the program office, should move to obtain mortgagee-in-possession (MIP) status, either voluntary or involuntary. (See Appendix 4, Parts VI and VII.) Field Offices should follow the outstanding instructions regarding the process for achieving mortgagee-in-possession status.

IMPORTANT! The Field Office must request/start foreclosure concurrently with the commencement of

MIP status. This is imperative and MUST be adhered to in all cases.

When the Department is awarded the mortgagee-in-possession status, the Director of Housing Management should authorize the managing agent to begin making the needed repairs as quickly as possible to restore the project to acceptable living standards. The repairs should be paid for out of project income and the Insurance Fund.

c. Initiation of Litigation.

If the situation is such that the housing is below acceptable levels, but the documentation or problem would not support a default based on the regulatory agreement or the "Waste" provision of the mortgage, a determination should be made as to the advisability of initiating immediate

4350.1 REV-1

litigation against the owner. Civil money penalties should also be utilized where appropriate to ensure compliance with the procedures outlined above.

- d. The Director of Housing Management may recommend the removal of a previously cited technical default to the Regional Administrator or his/her designee. The recommendation should be documented and in writing and should explain the circumstances surrounding the recommendation.

REGIONAL COUNSEL must review and concur on ALL notices of intent to declare a technical default and ALL subsequent correspondence to the owner.

- 6-27. INSPECTION OF UNITS IN THE SECTION 8 SPECIAL ALLOCATIONS (LMSA/PDSA) PROGRAMS with HUD-insured or HUD-held mortgages will be a reasonable sampling unless the Field Office feels it is necessary to inspect more or fewer units. A reasonable sample of units to be inspected would be:

1 unit to 50 units	-	15 percent
50 to 100 units	-	12.5 percent (7 units minimum)
Over 100 units	-	10 percent (12 units minimum)

If inspection of assisted units indicates there are problems, the servicer should increase the number of units inspected. The Loan Management Branch Chief may authorize or require a lesser or greater number of units to be inspected.

- 6-28. INSPECTION OF ARMED SERVICES HOUSING PROJECTS
In lieu of both HUD and mortgagee inspections, HUD accepts certification of the Department of Defense that all required inspections have been performed with respect to all Armed Services Housing projects acquired by the Department of Defense.

Instructions for Completing
Management Reviews of
Multifamily Projects

form [HUD-9834](#) (9/91)
ref. handbooks 4355.1 & 4350.1

Page 1

6-47

9/92

4350.1 REV-1

APPENDIX 1

Management Review
Summary Sheet

Page 2

form [HUD-9834](#)

9/92

6-48

4350.1 REV-1

APPENDIX 1

Page 3

form [HUD-9834](#)

6-49

9/92

4350.1 REV-1

APPENDIX 1

Management Review
Questionnaire

9/92

6-50

4350.1 REV-1

APPENDIX 1

6-51

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-52

4350.1 REV-1

APPENDIX 1

6-53

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-54

4350.1 REV-1

APPENDIX 1

6-55

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-56

4350.1 REV-1

APPENDIX 1

6-57

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-58

4350.1 REV-1

APPENDIX 1

6-59

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-60

4350.1 REV-1

APPENDIX 1

6-61

9/92

4350.1 REV-1

APPENDIX 1

Page 16	form HUD-9834
---------	-------------------------------

9/92

6-62

4350.1 REV-1

APPENDIX 1

Page 17	form HUD-9834
---------	-------------------------------

6-63

9/92

4350.1 REV-1

APPENDIX 1

Page 18	form HUD-9834
---------	-------------------------------

9/92

6-64

4350.1 REV-1

APPENDIX 1

Page 19	form HUD-9834
---------	-------------------------------

6-65

9/92

4350.1 REV-1

APPENDIX 1

9/92

6-66

4350.1 REV-1

APPENDIX 1

Physical Inspection Report

form HUD-9822 (1/90)
ref. handbooks 4350.1

Page 1 of 2

6-67

9/92

4350.1 REV-1

APPENDIX 1

form HUD-9822

Page 2 of 2

9/92

6-68

4350.1 REV-1

APPENDIX 3

INDICATORS FOR TROUBLED/POTENTIALLY TROUBLED PROJECTS

A multifamily project may be considered troubled when it requires assistance in order to meet its obligations and/or to provide the quality of housing and services to which its owner committed in the subsidy contracts and/or regulatory agreement. Potentially troubled projects are those where (1) critical information regarding the operation of the project is not available or (2)

where the project's situation is such that it may soon require assistance if action is not taken to address existing or emerging difficulties. Indicators that such a situation may exist include:

1. The project has a high or increasing vacancy rate.
2. A major system in the project requires replacement, major repair, or repair beyond existing or potential project resources.
3. The project has persistent physical problems of a serious nature (such as health and safety problems, security problems, deferred maintenance, or lack of janitorial services or routine maintenance).
4. There have been improper or unauthorized distributions, as defined in HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, or unauthorized diversion of project assets.
5. The Management Review or other financial analysis determined that annual or monthly operating expenses exceed income potential and will more than likely continue.
6. Project expenses are abnormally high or low compared to previous years or comparable projects.
6. Project rents are abnormally low or in-excess of authorized limits.
7. The owner/sponsor has threatened or has declared bankruptcy.
8. There has been more than one request from the owner(s) to use Reserve for Replacement Account money for the mortgage payment, fuel, utilities, insurance, security or for routine expenses for which the account was never intended.

9. The Management Review reveals management policies or procedures that jeopardize the project, as indicated by a rating of below satisfactory in one or more categories.
10. There are persistent, validated tenant complaints of a serious nature, including but not limited to harassment, leasing irregularities, improper certification, discrimination, or fraud by the project management or owner.

11. The owner/agent have not met their contractual, statutory and/or managerial obligations and have not developed programs to address them.
12. Annual financial statements disclose significant irregularities, such as qualified auditor's opinions; negative cash throw-offs; line items that are inconsistent with each other, with the prior years, or with similar projects; under funded General Operating Reserves (GOR), Replacement for Reserves, or escrow accounts; or increasing accounts payable, receivables, or bad debts.
13. Failure to provide required or requested data with respect to fiscal items for significant matters involving the management/operation of the project.
14. Physical inspection indicates serious emergency health and safety hazards for which there is no acceptable plan of correction.
15. Section 8 units do not meet HQS and project funds are not available to immediately correct the deficiencies.
16. Serious drug problems prevail in the complex or in the neighborhood.
17. In the case of a non-profit, the Board does not meet the criteria used when it was originally constituted.
18. Owner has threatened to abandon or has abandoned the complex.
19. Commercial space is unrentable or is being rented at uneconomic rents, causing a cash drain on the project, or commercial space detracts from project liveability.
21. The mortgage is in default.

9/92

6-70

4350.1 REV-1

APPENDIX 4

ROLE OF FIELD AND REGIONAL COUNSEL IN
COMPREHENSIVE MULTIFAMILY SERVICING

I. INTRODUCTION

The primary role of Field Counsel (counsel other than Regional Counsel) will occur in the initial stages of the Physical Inspection process and will be one of reviewer for legal sufficiency. The primary role of Regional Counsel will occur in

the later stages of the Physical Inspection process and will primarily be one of reviewing for Regional consistency as well as preparation for litigation. The Field Counsel review will occur at several stages. The first review will occur when the program office designates a multifamily project physical deficiencies as "serious." The second will occur when the corrective plan is established and monitored. The third level will occur when the project is targeted for a technical default where Field Counsel will be available to assist the Regional Counsel with respect to the declaration of default and any related litigation.

We will go over each of these stages. It is important to remember that the program office is responsible for the decision-making and that counsel's role is to advise the program office of any legal issues and to implement the program decision.

II. DESIGNATION OF DEFICIENCIES AS "SERIOUS"

Section 3 of Chapter 6 of the Handbook 4350.1 discusses the designation of deficiencies noted in the physical inspection as "serious" or "non-serious." The notice requires the field office to establish its own criteria and suggests factors such as the immediacy of the need for repair, its impact upon health and safety, etc. Because this initial designation of a physical defect is material to HUD later being able to declare a technical default, it is important that a legal policy review occur at this stage. Although the eventual technical default may occur as a failure to correct the Regulatory Agreement contractual obligation or to maintain the mortgaged premises in good repair - we believe HUD will be in a stronger position if the waste provision of the mortgage is violated. Accordingly, the standard for legal review should be: Is the physical deficiency of such a material nature as to constitute waste.

There is no Federal law on what constitutes waste. Accordingly, state law must be researched because that is the law to be applied in any litigation. Once you have completed the legal research on this point, a review of the documentation must be conducted to determine if the evidence in this case meets the legal standards. In the event that your review indicates that this situation does not constitute waste, you must advise the program office of:

- 1) Any additional documentation you may need to determine if waste is present, or
- 2) If the problem is not one of documentation but rather is one

of the degree of the physical defects, you should advise the client of the result of your review.

Because the legal standard of waste is more difficult to meet, if waste is present the legal standard to show a breach of the Regulatory Agreement will be met. However, if waste is not present, you must determine if the documentation would support a finding of "failure to maintain in good repair". In the event that this standard is not met, you must advise the client of your determination and prepare a written recommendation supporting your decision not to regard the deficiencies as "serious."

In all reviews, any written opinions are privileged communications and all documents should be marked "Privileged-Prepared in Anticipation of Litigation" and the program office should be instructed not to waive their privilege by releasing this work product.

III. ESTABLISHING AND MONITORING THE CORRECTIVE ACTION PROGRAM

Again, because the establishment of an acceptable corrective action program may result in the initiation of litigation, a legal review by the Field Counsel's office is necessary at this stage. The notice states that the fact that the project does not generate sufficient cash flow is not a justification for not infusing such resources. While this fact when examined in isolation is correct, if surrounded by facts that indicate substantial government complicity, such as HUD written acceptance of physical deficiencies, this may impair or affect HUD's present decisions on how best to proceed.

9/92

6-72

4350.1 REV-1

APPENDIX 4

The decisions of the program office must be reviewed to ensure that they are not arbitrary and capricious. In some circumstances, the proposed corrective action may not be an appropriate position for the program office to take. This issue is an administrative law issue and we have prepared some case law guidelines which are attached as Supplement A hereto. Beyond the issue of arbitrary and capricious government action, when reviewing the program office's actions and decision, be attentive to the classification of the mortgagor to determine if it falls into a "suspect classification" making the Department vulnerable to discrimination claims. It is imperative that your legal review assures fair and even-handed treatment of all mortgagors.

In addition, at this stage, you should review the administrative record for accuracy. Is the name of the mortgagor correct? What's the financial status of mortgage payments? Have

there been any unauthorized transfers of physical assets? Make certain that all information necessary to declare a technical default is accurate and able.

IV. DECLARATION OF TECHNICAL DEFAULT UNDER THE REGULATORY AGREEMENT

In Section 3.6-26. of Chapter 6 of the Handbook 4350.1 the stages on which the field office may notify the mortgagor of its intent to declare a technical default are detailed. In the event the legal review in the stage where the physical defect is determined to be "serious" has resulted in Field Counsel's opinion that waste is present, the legal review will simply turn on the issues of whether there is evidence of non-response or non-compliance. In the event that waste is not present, the Field Counsel must review the proof of the breach of the Regulatory Agreement provision requiring the owner to maintain the project in good repair.

The program office decision to declare a technical default under the Regulatory Agreement for failure to maintain the property in good repair must be reviewed by the Field Counsel. This review must result in either the recommendation in favor of the determination or a recommendation against the determination for failure to meet the legal standards necessary in that jurisdiction. As discussed before, the Regulatory Agreement standard is a lesser standard than that of the mortgage covenant default for waste. Field Counsel should review all documentation utilized by the program office in making its determination that the project is not in good repair. Field Counsel must be assured that there is sufficient documentation and that this data is

specific, contains specific detail and maintains a level of objectivity and consistency which would support a determination of lack of repair.

In the event Field Counsel does not believe that there is sufficient evidence of disrepair, Field Counsel should make one of the following recommendations:

1. Recommendation to redesignate the project - identify physical deficiencies as non-serious and remove from consideration. This recommendation should set forth the reasoning that there is insufficient evidence to meet the legal test for disrepair.
2. Recommendation for further information. Field Counsel

believes that further documentation is necessary prior to designation as troubled. Field Counsel should prepare a recommendation of the type of documentation necessary for a thorough review to be conducted.

3. Recommendation to redesignate because of HUD's actions. In the event there is sufficient evidence to declare a technical default, a 30-day demand letter must be sent to the mortgagor describing the contract violation and allowing the mortgagor a 30-day time period to correct. At this stage, the Regional Counsel's Office must review the demand letter that should be signed by the Regional Administrator. We have attached Sample 30-day demand letters for your assistance in Supplement B.

V. INSTRUCTION TO MORTGAGEES REQUIRING/REQUESTING THE ACCELERATION OF THE MORTGAGE INDEBTEDNESS DUE TO VIOLATION OF THE WASTE PROVISION OF THE MORTGAGE OR DUE TO VIOLATION OF THE REGULATORY AGREEMENT

We have attached as Supplement C, a letter to the mortgagee requiring acceleration of the mortgage indebtedness due to the mortgagor's violation of the waste provision of the mortgage. For projects where the technical default rests on the mortgagor's failure to comply with its contractual obligation under the Regulatory Agreement to maintain the premises in good repair, a letter requesting acceleration of the full mortgage indebtedness should be sent to the mortgagee. This letter should be prepared by the Regional Counsel with the necessary concurrences from the field and regional program offices. At this point, Regional Counsel should work with the program office to determine when the mortgagee has notified the mortgagor of the debt acceleration and

9/92

6-74

4350.1 REV-1

APPENDIX 4

determine when the mortgagee has prepared the election to assign. Regional Counsel should communicate with the Multifamily Mortgage Division and the Office of Multifamily Housing Management to ensure that any elections to assign as a result of technical default, are processed in an expeditious manner.

VI. ATTEMPT TO OBTAIN VOLUNTARY MORTGAGEE-IN-POSSESSION STATUS

During the processing of the claim for mortgage insurance benefits, Regional Counsel should, upon instruction by the appropriate program office, approach the mortgagor to obtain a voluntary mortgagee-in-possession status once HUD is in the legal position to exert its right as mortgagor. A sample format has been attached as Supplement D.

VII. INVOLUNTARY MORTGAGEE-IN-POSSESSION STATUS

If the mortgagor indicates a reluctance or refusal to sign a voluntary mortgagee-in-possession agreement, Regional Counsel should prepare for mortgagee-in-possession as an affirmative right. Regional Counsel must prepare a complaint, memorandum of law, and all supporting affidavits. We have attached as Supplement E, sample pleadings for guidance to Field Counsel; however, the law in every jurisdiction must be reviewed and the facts of each case must be specifically spelled out. Once the proposed pleadings are prepared, Field Counsel should send them to the appropriate U.S. Attorneys Office with copies to:

J. Christopher Kohn
Director, Commercial Litigation Branch
Department of Justice
P. O. Box 875
Ben Franklin Station
Washington, D.C. 20044

Herbert L. Goldblatt, Assistant General Counsel
ATTN: Nancy Christopher
Department of Housing and Urban Development
Room 10270
451 7th Street, S.W.
Washington, D.C. 20410

6-75

9/92

4350.1 REV-1

APPENDIX 4

SUPPLEMENT A

Because HUD has not previously implemented such a Physical Inspection policy in Chapter 6 of the Handbook 4350.1, we must review HUD's decisions in light of the case law already established. Because this policy may ultimately result in a "taking" of property interest, it is imperative to examine HUD's determinations with a critical eye. A decision by HUD to foreclose is subject to limited judicial review under the "arbitrary and capricious" standard of the Administrative Procedure Act (APA). U.S. v. Victory Highway Village, Inc., 662

F.2d 488, 494 (8th Cir. 1981), citing U.S. v. Winthrop Towers,
628 F.2d 1028 (7th Cir. 1980). Section 706(2) of the APA
authorizes a reviewing

court to hold unlawful and set aside agency action,
findings and conclusions found to be . . . arbitrary,
capricious, an abuse of discretion, or otherwise not in
accordance with law.

Hence, when APA review is available, the scope of judicial review
is limited to analysis of the administrative record to determine
whether the agency's action was "arbitrary, capricious, an abuse
of discretion, or otherwise not in accordance with the law."

Camp v. Pitts, 411 U.S. 138 (1973); Citizens to Preserve Overton
Park v. Volpe, 401 U.S. 402 (1971). In the case of the
designation of troubled project and particularly the
determination that a technical default is warranted, the Field

9/92

6-76

4350.1 REV-1

APPENDIX 4

Counsel should identify and review the full contents of the
administrative record.

STANDARD OF REVIEW

In applying the arbitrary and capricious standard, judicial
review is limited to whether the agency action was "rational,
based on relevant factors within the agency's statutory
authority." Motor vehicle rafts. Ass'n v. State Farm Mut. Ins.
Co., 463 U.S. 29 (1983) 1/; Frisby v. U.S. Dept, of HUD, 755
F.2d 1052 (3rd Cir. 1985) 2/. The ultimate standard of review
of an agency is a narrow one. Citizens, 401 U.S. at 416. See

1/ National Highway Traffic Safety Administration's (NHTSA's) recision of motor vehicle passive restraint standard was held arbitrary and capricious. In 1977, the NHTSA issued a motor vehicle safety standard pursuant to the National Traffic and Motor Vehicle Safety Act that required newly sold cars to be equipped with either air bags or detachable/nondetachable seat belts as of 1982 or 1984 model year. But before that date, the agency issued a final rule rescinding the passive restraint requirement in the standard, the agency stating that the requirement was no longer reasonable or practical in view of the minimal safety benefits and the costs of implementing the requirement. On certiorari, the Supreme Court, held NHTSA's recision arbitrary and capricious since the agency failed to present an adequate basis and explanation, and failed to supply the requisite reasoned analysis for its action.

2/ Class action suit was brought to enjoin sale of multifamily housing project by HUD to a private developer without rehabilitation requirements and Section 8 certificates being attached to sale. The U.S. District Court of New Jersey refused to grant the injunction and appeal was taken. The Court of Appeals held that Congress has vested Secretary of HUD with discretion in deciding, with regard to disposition of a multifamily housing project, which statutory goals are to be furthered and that sale of the project without rehabilitation requirements and without Section 8 certificates was not arbitrary, capricious, or an abuse of discretion since Secretary balanced cost-effectiveness of disposing of project against competing goals of furthering housing-related objectives and reached a reasonable decision.

4350.1 REV-1

APPENDIX 4

also, *Anderson v. HUD*, 701 F. 2d 112, 113-15 (10th Cir. 1983) 3/; *Roberts v. HUD*, 473 F. Supp. 52, 54-5 (N.D. Miss. 1979). 4/ Thus, where a decision is committed to agency discretion, a court in reviewing that decision, is limited to the standard for review set forth in 5 U.S.C. Section 706(2)(A).

Therefore, the Court is to decide only whether the agency's decision was based on a consideration of relevant factors, and whether there has been a clear error of judgment. Federal Nat.

Mortg. Ass'n v. Rathgens, 595 F. Supp. 552, 555, (S.D. Ohio

1984). In considering

whether agency action was based on relevant factors, the reviewing court normally must determine whether the agency relied on factors Congress intended it to consider. If the Court determines that the agency relied on factors that Congress intended it to consider. If the Court determines that the agency relied on factors that Congress did not intend for it to consider, or has failed to consider an important

3/ Mortgagor brought action for declaratory and injunctive relief and for review of HUD's decision denying request for acceptance of a mortgage assignment. U.S. District Court of Colorado denied relief and mortgagor appealed. Court of Appeals held that HUD's denial was not arbitrary, capricious, or abuse of discretion because controlling test is whether record facts supporting agency action are adequately adduced and rationally applied.

4/ Court concluded that HUD's administrative decision with respect to application of national flood insurance program to the city of Aberdeen, Mississippi, based on known historical flood data, was not arbitrary and capricious, but rather, procedural steps required by statute and applicable regulations were followed with meticulous care. Hence, because fact finding procedures were considered adequate, the receipt of additional evidence on a de novo hearing before district court was unnecessary.

9/92

6-78

4350.1 REV-1

APPENDIX 4

aspect of the problem, the action should be set aside as arbitrary and Capricious. Frisby, 755 F.2d at 1055.

If HUD's fact finding procedures in a particular case would be inadequate and civil penalties were imposed upon a mortgagee or lender by an administrative law judge, the mortgagee or lender would be entitled to a trial de novo. Otherwise, any judicial review would be based on the administrative record.

As the case law indicates, courts are reluctant to intervene where Congress has granted an agency discretion, and resulting decisions are subject to judicial review only to determine whether an agency has exceeded statutory authority or has acted arbitrarily. Further, the agency action is entitled to a presumption of regularity and the burden of proof rests with the non-governmental party. More importantly, agency action will not be set aside on grounds that it is arbitrary and capricious if the action is rational, based on relevant factors, and within the agency's statutory authority. As a safeguard, it would be wise to keep in mind that a reviewing court must determine whether the agency considered relevant data and articulated an explanation establishing a rational connection between the facts found and the choice made. 5/

5/ Frisby, 755 F.2d at 1055, citing Burlington Truck Lines v. United States, 371 U.S. 156, 168, 83 S.Ct. 239, 246, 9 L.Ed. 2d 207 (1962).

6-79

9/92

4350.1 REV-1

APPENDIX 4

SUPPLEMENT B

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Mr.

RE: Violation of Regulation Agreement

Dear Mr.

This letter will constitute formal notice by the Secretary of the Department of Housing and Urban Development that you are in default of the Regulatory Agreement executed between yourself

and HUD. You have violated the Regulatory Agreement contract which requires you to maintain the mortgaged premises, accommodations, and grounds in good repair and condition. By your failure to so maintain the Navajo Apartments project, you have violated the mortgage's contractual obligation that you not commit waste upon the mortgaged premises. By letter of 1985, _____, Chief of Loan Management in HUD's _____, field office, informed you of your violation of the Regulatory Agreement and mortgage. To date, you have failed to correct these violations. Accordingly, the Secretary hereby declares you in default to these contracts and is thus entitled to pursue the remedies therein provided.

Before initiating litigation, however, we will provide you with an opportunity to discuss your proposals to remedy this situation. We will delay our request to the Department of Justice to pursue litigation, including the alternatives of specific performance or foreclosure, for 30 days. To set up a meeting with my staff in _____, please contact, or have your attorney contact, _____, Office of _____ Counsel, at _____. If you prefer to submit a written response, please send it to _____ at Room _____.

If you fail to respond to the Secretary's satisfaction within 30 days, be advised that the Secretary will institute suit. In such event, attorneys' fees are not eligible project expense.

Sincerely,

9/92

6-80

4350.1 REV-1

APPENDIX 4

(USE OFFICE OF THE ASSISTANT SECRETARY FOR HOUSING
- FEDERAL HOUSING COMMISSIONER STATIONERY)

SUPPLEMENT C

Re: _____ - Project No. _____

Dear Mr. _____:

The Department of Housing and Urban Development (the "Department" or "HUD") has compiled documentation showing that _____ (the "Owner") has failed to maintain _____ (the "Project") in good repair and condition, and thus has violated paragraph 10 of the HUD-insured Mortgage (the "mortgage") held by _____. Paragraph 10 provides in part as follows:

AND MORTGAGOR COVENANTS, PROMISES, AND AGREES HEREBY:

* * * * *

10. To commit or suffer no waste of said property, and to maintain and keep the buildings, fences, and other improvements to be erected on said premises in good repair and condition. . . .

* * * * *

Therefore, pursuant to 24 CFR 207.257, the Department hereby exercises its right to require _____ to accelerate payment of the outstanding principal balance due on the Mortgage on the basis of this violation. You are hereby directed to immediately send a notice of acceleration to the Owner, with a copy of the undersigned.

_____ declaration of default and acceleration of the debt pursuant to this letter shall constitute an event of default as provided in section 207.255(a)(2) of the regulations. Upon expiration of the thirty day grace period specified in 207.255(c) of the regulations, _____ shall be entitled pursuant to 207.258(a) to give the Department notice of its intention to file an insurance claim and of its election to assign the Mortgage. Because of the Department's interest in restoring the Project to satisfactory condition as soon as possible, we request that you expedite the filing of this insurance claim. In this connection please contact _____ at _____ to arrange for the assignment.

6-81

9/92

4350.1 REV-1

APPENDIX 4

SUPPLEMENT D

(Mortgagor Name
and Address)

Re: Project Name: _____
Location: _____
Project No. _____

Dear _____:

This letter, when properly executed by an authorized officer of _____ (herein called the "Mortgagor"), shall constitute an agreement between the Mortgagor and the Secretary of Housing and Urban Development (herein called the "Secretary"), acting by and through _____ (title) _____, _____ (name) _____, with regard to FHA Project No. _____

_____ (herein called the "Project").

WHEREAS, the Mortgagor has failed to make payments owed to the Secretary under a Mortgage Note secured by the Project, and has been duly declared to be in default by the Secretary;

WHEREAS, the Regulatory Agreement entered into between the Mortgagor and Secretary provides that the Secretary may take possession of the project after such default by the Mortgagor;

WHEREAS, the Mortgagor and Secretary wish to provide for the orderly and peaceable transfer of the possession and Management of the Project from the mortgagor to the Secretary.

NOW, THEREFORE, the Mortgagor and the Secretary agree as follows:

1. The Mortgagor will deliver to the Secretary or his agents possession of all the property, real, personal or mixed, associated with derived from or used in the operation of the Project.
2. The mortgagor and his agent will refrain from interfering in any way with the possession, preservation, operation and management of the Project by the Secretary or his agents.

9/92

6-82

4350.1 REV-1

APPENDIX 4

2

3. The Mortgagor hereby assigns to the Secretary the right to collect and receive all rents, charges and profits from the Project. The Secretary agrees to use this Project income to pay necessary expenses for operating and preserving the Project and to also pay the Mortgagor's obligations under the Note and Mortgage when Project income exceeds operating expenses. When operating expenses exceed project income, any advances made by the secretary will be added to the outstanding indebtedness due and payable under the Mortgage.
4. The mortgagor shall deliver to the Secretary forthwith, but in no event later than _____, the following:
 - (a) All funds held as tenant security deposits, along with an accounting for each tenant of the amount collected and date of collection.

- (b) All funds in Project operating accounts, reserve fund accounts and any other accounts derived from or associated with the operating of the Project.
 - (c) All existing leases, entered into between the Mortgagor and the current tenants of the Project, and a schedule of current rental rates.
 - (d) All supplies, furniture, equipment and other personal property associated with the Project.
 - (e) All existing service contracts for the Project including, but not limited to, contracts for landscaping, pest control, metered laundry equipment, air-conditioning and heating.
5. The Mortgagor will preserve all financial records, books of account and related materials and make them available to the Secretary for inspection at any time. The Mortgagor will also provide the Secretary with a final financial accounting for the project covering the period from the Mortgagor's last audited financial statement to the date of possession by the Secretary. This accounting must be prepared by an independent public accountant and certified by the accountant and the Mortgagor in accordance with the requirement of HUD Handbook 4372.1. The Mortgagor shall provide this accounting by _____.

6-83

9/92

4350.1 REV-1

APPENDIX 4

3

- 6. The Mortgagor acknowledges that the Secretary may act as the agent of the Mortgagor and any other party who has ownership interest in the project when necessary to carry out all management functions at the project, such as tenant evictions and rent increases, which are reserved to property owners by state law.
- 7. The Mortgagor acknowledges that the Secretary, in taking possession of this project, assumes none of the liabilities, costs or expenses incurred by the Mortgagor prior to the taking of possession by the Secretary.
- 8. The Mortgagor acknowledges that the actions detailed herein are to be taken without prejudice to or waiver

of any right of the Secretary in any matter that has or may arise in connection with the Project.

Secretary of Housing and
Urban Development

Mortgagor:

By: _____

By: _____

Title: _____

Title: _____

Date: _____

Date: _____

9/92

6-84

4350.1 REV-1

APPENDIX 4

(USE OFFICE OF GENERAL COUNSEL STATIONERY)

SUPPLEMENT E

J. Christopher Kohn, Esquire
Director, Commercial Litigation Branch
Civil Division
U.S. Department of Justice
Post Office Box 875
Ben Franklin Station
Washington, DC 20044

Re:

Dear Mr. Kohn:

Enclosed are proposed complaints against the owners of three multifamily housing projects in _____, and the contract purchasers of each of the three projects. The complaints are based on the defendant's failure to properly maintain the projects and they seek orders placing HUD in possession of each of the three projects. After assuming possession of the projects, which are badly deteriorated, HUD intends to perform extensive repairs.

At the present time, the mortgages on the two of the three projects are held by HUD while the third is held by a private lender. The holder of the third mortgage is in the process of assigning the mortgage to HUD. HUD does not have the statutory authority to advance money from its insurance funds to perform necessary repairs before HUD acquires the mortgage. Therefore, the complaint concerning the privately held mortgage should not be filed until the assignment of the mortgage for that project is placed on record. We will notify you immediately after the assignment has been recorded.

We believe that our interests in these cases will best be protected by filing of motions for summary judgment as soon as possible after the cases have been filed. Enclosed is a proposed memorandum and declaration to support such a motion in one case. The declaration has been reviewed and approved by the potential declarant. These documents can be used as a model for memorandums filed in the other cases or they can be modified to cover all of the cases if they are consolidated by the court.

6-85

9/92

4350.1 REV-1

APPENDIX 4

FACTS

The low and moderate income housing projects were built with the proceeds of loans which were insured against default by the Secretary of HUD under Section 221(d)(3) of the National Housing Act, 12 U.S.C. 17151(d)(3), or Section 236 of the National Housing Act, 12 U.S.C. 17151z-1. The loans were made in the late and early , and there are a total of units in the three projects. Each project is owned by a separate nonprofit corporation which is affiliated with

In consideration for the mortgage insurance provided by the Secretary, the owners entered into Regulatory Agreement contracts with the Secretary which impose certain restrictions on the way the owner operates the project. The Regulatory Agreements provide, among other things, that the owners must maintain the projects "in good repair and condition" and that the owners may not sell or convey the projects without HUD's approval.

The Regulatory Agreements specify several remedies which are available to HUD if the owner should fail to observe its obligations thereunder. Among these is the right to:

Take possession of the project ... and operate the project in accordance with the terms of this Agreement until such time as the Secretary in his discretion determines that the Owners are again in a position to operate the project in accordance with the terms of this Agreement.

Paragraph 12 (c) .

The projects were opened in stages between and . Almost from the start, they were in physical and financial trouble even though HUD provided cash rental subsidies for 100 of the units under Section 8 of the Housing Act of 1937, 42 U.S.C. 1437f. Today, HUD subsidizes

all of the units in the projects. The situation stabilized in the middle and late 1970's, but by 1980, the projects were once again in serious trouble. In the next several years, HUD consented to a mortgage modification agreement and provided nearly to repair the roofs and make other needed repairs. Despite these and other efforts, however, the physical condition of the projects continued to deteriorate. Throughout this period, the nonprofit owners and their sponsor, believed that they could reserve the projects, fortunes even

9/92

6-86

4350.1 REV-1

APPENDIX 4

though they had no money of their own and even though HUD continually rated the management as less-than-satisfactory.

In 1987, , Inc. finally recognized that the projects could not be saved unless a new owner was found with the resources to begin a comprehensive repair program. After reviewing proposals and inspecting other projects that had been purchased and improved, , Inc. selected to purchase and syndicate the projects. In December 1987, the owners executed Agreements of Sale under which they agreed to sell the projects to partnerships controlled by . Copies of these Agreements are attached to the proposed complaints as Exhibit B.

Under these Agreements, the purchasing partnerships acquired equitable title to the projects, along with all of the benefits and obligations of ownership, Paragraph 3.F. The sale of the projects was specifically contingent on HUD's approval of the transactions, Paragraph 3.A., and the purchasers agreed to reconvey their interest in the projects to the owners if HUD disapproved, Paragraph 3.F.(2)(f). In addition, the purchasers specifically agreed to be bound by the terms of the Regulatory Agreements, Paragraph 3.F.(2)(g).

In September 1988, the purchasers took control of the projects and appointed as their manager. is affiliated with through an extensive network of interrelated companies.

In April 1988, the purchasers submitted formal applications for HUD's approval of the sales. After reviewing the applications, HUD determined that the purchasers did not have sufficient resources to adequately repair the project and that HUD did not have funding available for this purpose. For this reason, HUD could not immediately approve the sales, but negotiations between HUD and the purchasers continued until

January 1990 when, for reasons not related to these projects, HUD excluded and other affiliated organizations from further participation in HUD programs. Shortly thereafter, HUD formally disapproved the transfers and ordered the purchasers to reconvey, and the owners to reacquire, the interests which were transferred to the purchasers under the Agreements of Sale. To date, neither the owners nor the purchasers have taken any steps to effectuate a reconveyance. managed the projects until October 1990, when the purchasers notified HUD that they had appointed as the management agent for the complex.

6-87

9/92

4350.1 REV-1

APPENDIX 4

Although each of the project loans is now current, the physical conditions at the complex have not improved since the contract purchasers assumed management. As more fully described in the enclosed pleadings, the complex has major plumbing and heating problems. Also, one of the three phases needs a new roof and many of the porch and stairway railings are dangerously loose. Vandalism is rampant and security is nonexistent. Violence is so prevalent that recent reports in the media have compared it to Dodge City. Secretary Kemp has visited the complex twice in the past several months and has stressed to all concerned the need to take action to correct the problems there.

Legal Analysis

Our request to be placed in possession of the projects is based on paragraph 12(c) of the Regulatory Agreements which, as described above, permits HUD to

Take possession of the project...and operate the project in accordance with the terms of this Agreement until such time as the Secretary in his discretion determines that the owners are again in a position to operate the project in accordance with the terms of this Agreement.

We are not aware of any case law interpreting this precise provision. However, there are several reported cases in which HUD has been given control of a project, or a receiver has been appointed to operate a project, pending foreclosure under a similar provision in the project's mortgage. 1/

In some of these cases, the court has established a receivership solely on the basis of the contractual provision authorizing it. *United States v. Queen's Court Apartments, Ltd.*, 296 F2d 534 (9th Cir, 1961); *Garden Homes, Inc., v. United*

States, 207 F.2d 459 (1st Cir. 1953); United States v. Mountain Village Company, 424 F.Supp. 822 (D. Mass. 1976). Other courts have looked beyond the contractual right to possession or receivership to see if other equitable factors exist which will persuade it to grant the request. One of the factors which has typically satisfied the court's search is the physical deterioration of the property and the danger of waste. United States v. Cedar-Riverside Land Company 592 F.2d 470 (8th Cir. 1979); United States v. Queen's Court Apartments, Inc., 288 F.2d (9th Cir.1961); View Crest Garden Apartments, Inc. v. United States, 281 F.2d 844 (9th Cir. 1960).

9/92

6-88

4350.1 REV-1

APPENDIX 4

As explained earlier, there is more than ample evidence to show that the defendants have failed to adequately maintain the projects.

Courts have also noted that the policies behind the National Housing Act are relevant considerations when deciding whether to

1/ Most of these cases concern the establishment of a receivership rather than the appointment of HUD as mortgagee-in-possession (MIP) as requested here. But courts have considered a request for MIP status to be an alternative to a request for the creation of a receivership, and will almost certainly apply the same standards when deciding whether to grant either request. See, United States v. St. Paul Missionary Public Housing, Inc., 575 F.Supp. 867 (N.D. Ohio 1983). See also, United States v. American National Bank and Trust Company of Chicago 573 F.Supp. 1317 (N.D. Ill. 1983).

6-89

9/92

4350.1 REV-1

APPENDIX 4

implement remedies at a HUD-involved project when the Regulatory Agreement has been violated. The Regulatory Agreement was designed to advance the policies of the National Housing Act, and the obligations imposed by the Regulatory Agreement on the owner "were exacted in order to comply with the requirements of the

National Housing Act and the Regulations ... " United States v. Haddon Haciendas. 541 F.2d 777, 784 (9th Cir 1976). Accordingly, the relief HUD is seeking should be granted, if for no other reason, because to do so would be to advance the goals of the National Housing Act by improving the living conditions at the complex.

Although the project loans are still current, HUD has requested the insured lenders to declare the loans to be in default because of the owner's failure to maintain the projects (this is a violation of the project's mortgages as well as a violation of the Regulatory Agreements) and to assign the loans to HUD. Two of the lenders have completed the assignments and the third is in the process of doing so. When HUD holds the mortgage on a project, it has the right to advance money from its General Insurance Fund to implement an extensive repair program. 54 Comp.Gen. 1061 (1975). HUD has begun the administrative process for foreclosing the two HUD-held mortgages, but it will be several months before the foreclosures can be concluded, and the problems at the complex are so severe that HUD does not wish to wait for foreclosure before addressing them. The most expeditious way to address these problems is through the litigation requested herein.

We believe that service on the owners

Inc. can be made through , the President of each organization, at . According to the sale contracts, the purchasers can be served at

is the attorney on my staff who is assigned to this case. If you need further information about any of the matters discussed in this letter, you may contact

Enclosures

9/92

6-90

4350.1 REV-1

APPENDIX 4

UNITED STATES DISTRICT COURT

UNITED STATES OF AMERICA,

Plaintiff

V.

Civil Action No.

Defendants.

COMPLAINT

Comes now the United States of America on behalf of the Secretary of Housing and Urban Development (HUD) and respectfully brings this action for an order authorizing HUD to take possession of the housing project in

JURISDICTION

1. This Court has jurisdiction over this civil action under 28 U.S.C. 1345.

VENUE

2. Venue is proper in the under 28 U.S.C. 1391(b).

PARTIES

3. Plaintiff is the United States of America suing on behalf of the Secretary of Housing and Urban Development ("the Secretary" or "HUD").

6-91	9/92
------	------

4350.1 REV-1
APPENDIX 4

4. ("the owner") is a corporation organized and existing under the laws of the State of and is the owner of and moderate income housing project located in ("the project").

5. Limited Partnership, a limited partnership,

STATUTORY AND REGULATORY SCHEME

6. Under Section 221 of the National Housing Act, 12 U.S.C

17151, the Secretary is authorized to assist private industry in providing housing for low- and moderate-income families by insuring mortgages which satisfy the eligibility requirements of 12 U.S. C. 17151 (d).

7. Each eligible mortgagor must agree to comply with the requirements of the Secretary with respect to rents, charges, and methods of operation as a condition precedent for receiving mortgage insurance in connection with the financing and construction of multifamily housing projects. 12 U.S.C. 17151(d)(3). To implement such requirements, the Secretary is authorized to enter into Regulatory Agreements with mortgagors who participate in the Secretary's mortgage insurance program. 12 U.S.C. 17151(d) (3).

9/92

6-92

4350.1 REV-1

APPENDIX 4

8. The Secretary of HUD is authorized to promulgate rules and regulations to carry out the various mortgage insurance and subsidy programs under Title II of the National Housing Act. 12 U.S.C. 17151(b).

9. Pursuant to 12 U.S.C. 17151(b), the Secretary has promulgated regulations governing the Section 221 insurance programs which appear at 24 C.F.R. 221.502 et seq. These regulations provide that the Federal Housing Commissioner may regulate and restrict the mortgagor by means of a Regulatory Agreement as long as the Commissioner is the insurer, holder or reinsurer of the mortgage. 24 C.F.R. 221.529.

FACTUAL STATEMENT

10. was built with the proceeds of a loan which was insured against default by the Secretary of HUD pursuant to Section 221(d)(3) of the Housing Act, 12 U.S.C. 1715(d)(3). The project was completed in

In consideration for the Secretary's agreement to insure repayment of the project loan, _____ Inc. (then known as _____) executed a Regulatory Agreement with the Secretary. A copy of the Regulatory Agreement is attached hereto as Exhibit A.

11. Paragraph 8 of the Regulatory Agreement requires the owner to "maintain the project , accommodations and the grounds and equipment appurtenant thereto, in good repair and condition."

6-93

9 / 92

4350.1 REV-1

APPENDIX 4

12. The Regulatory Agreement provides that

, may not convey, transfer or encumber the

project without the prior written approval of the Secretary.

Paragraph 7(a).

13. The Regulatory Agreement states at paragraph 12(c) that upon a breach by the owner of any provision, HUD may take possession of the project ... and operate the project under the terms of this Agreement until such time as the Secretary in his discretion determines that the owners are again in a position to operate the project in accordance with the terms of this Agreement.

14.

15. Pursuant to rights which were conferred by the

took

possession of the project in September 1988, and appointed an identity-of-interest company as its managing agent. The purchaser has had full responsibility for managing the project since then.

9/92

6-94

4350.1 REV-1

APPENDIX 4

CAUSE OF ACTION

BREACH OF CONTRACT - FAILURE TO MAINTAIN
THE PROJECT IN GOOD REPAIR

16. Plaintiff realleges paragraphs 1-16 above which are incorporated fully herein.

17. Contrary to their obligations under paragraph 8 of the Regulatory Agreement,

have failed to maintain the project in good repair and condition. This failure threatens the health and safety of the tenants.

18. As described above in paragraph 14, the Regulatory Agreement permits HUD to take possession of the project when the obligations thereunder have been violated and to manage the project until HUD determines that the owner can operate it in accordance with the terms of the Regulatory Agreement.

WHEREFORE PLAINTIFF PRAYS:

A. For an order placing HUD in possession of until such time as HUD, in its discretion, determines that

Limited

Partnership are capable of operating the project in accordance

6-95

9/92

4350.1 REV-1

APPENDIX 4

with the requirements of the Regulatory Agreement;

B. For all other relief this Court deems just and proper.

Dated: _____, 1990

United States Attorney

9/92

6-96

4350.1 REV-1

APPENDIX 4

UNITED STATES DISTRICT COURT

UNITED STATES OF AMERICA,

Plaintiff

V.

Civil Action No.

Defendants.

MEMORANDUM IN SUPPORT OF PLAINTIFF'S
MOTION FOR SUMMARY JUDGMENT

This memorandum is filed in support of a motion by the United States of America for the appointment of the Department of Housing and Urban Development (HUD) to take possession of and operate the _____ housing project, _____ was built with the proceeds of a loan which was insured against default by HUD under Section 221(d)(3) of the National Housing Act. Its owner, _____ agreed to

operate the project in compliance with certain reasonable conditions which are set forth in a Regulatory Agreement contract with HUD. The owner and other parties who are now bound by the Regulatory Agreement have failed to maintain the project in good repair and condition as required, and the health and safety of the tenants is threatened. As a result, it is vital to the interest of the tenants, the government, and the taxpayers that the project be taken away from the owner and that the relief requested in the government's motion be granted.

6-97

9/92

4350.1 REV-1

APPENDIX 4

I. STATEMENT OF FACTS

A. HUD's Obligations under the National Housing Act

Congress established HUD and the programs administered by the agency to address identified national housing objectives. Perhaps the most fundamental of these goals is the provision of "a decent home and suitable living environment for every American family." 42 U.S.C. 1441. Congress has authorized HUD to administer the programs contained in the National Housing Act ("the Act"), 12 U.S.C. 1702, and requires that, in doing so, HUD act in a manner consistent with and in furtherance of congressionally-stated national housing objectives. 42 U.S.C. 1441.

Section 221 of the Act, 12 U.S.C. 17151, created several mortgage insurance programs "to assist private industry in

providing housing for low and moderate income families and for displaced families." Under the programs pertaining to multifamily housing, the Secretary of HUD may insure loans made by private lenders to private developers or other owners for the purpose of building housing projects for low and moderate income tenants. If the borrower defaults on repayment of the loan, the insured lender may assign the mortgage to HUD in exchange for insurance payment, as provided in 24 C.F.R. 207.255 et seq. Upon assignment of the mortgage, HUD assumes all rights of the insured lender.

9/92

6-98

4350.1 REV-1

APPENDIX 4

B. The Project

is a multifamily housing project located in The project is owned by defendant ("the owner") and was built with the proceeds of a loan insured by HUD under Section 221(d)(3) of the Act. The project was completed in November 1970.

At the present time, the project is approximately occupied. Approximately people live there, of whom are children. Typically, the tenants are single parent families with low and moderate incomes. HUD provides cash rental subsidy payments for every unit in the project under Section 8 of the Housing Act of 1937, 42 U.S.C. 1437f. HUD began providing subsidies in when it authorized payments for 100 of the

units. HUD increased the coverage of these subsidies until, in 1988, all units were eligible for subsidy payments. These payments amount to roughly each month.

C. The Regulatory Agreement

To ensure that projects like serve the purpose intended by Congress, the Secretary of HUD

may, in his discretion, require the mortgagor to be regulated or restricted as to rents or sales, charges, capital structure, rate of return and methods of operation, with... any such mortgagor as the Secretary may deem necessary to render effective such restrictions and regulations.

6-99

9/92

4350.1 REV-1

APPENDIX 4

12 U.S.C. 17151d(3). See also, 24 C.F.R. 221.529.

At HUD elected to regulate the owner by requiring it to execute the standard Regulatory Agreement contract for Section 221(d)(3) projects. A copy of the Regulatory Agreement is attached to as Exhibit A hereto. The Regulatory Agreement contains numerous provisions which help HUD assure that the project and the money received by it are used to further the congressionally-mandated purpose. One of the owner's most important obligations is to maintain the project in good repair and condition. Paragraph 8. A project which is poorly maintained cannot provide a decent home or suitable living environment for the tenants.

If the owner fails to comply with its obligations under the Regulatory Agreement, HUD is specifically authorized to

take possession of the project ... and operate the project in accordance with the terms of this Agreement until such time as the Secretary in his discretion determines that the owners are again in a position to operate the project in accordance with the terms of this Agreement.

Paragraph 12 (c) .

D. Recent History

After years of steadily declining conditions at the project, HUD urged the owner to sell it to any organization which could restore the project to sound physical condition. The owner initially resisted, but, in late 1987 after reviewing other

9/92

6-100

4350.1 REV-1

APPENDIX 4

projects which had been purchased and restored, Limited Partnership ("the purchaser"). During the negotiations between the owner and the purchaser, HUD worked with both parties to identify the project's physical problems and to devise a plan for solving them.

The parties executed an under which the purchaser acquired equitable title to the project along with the paragraph 3.F. A copy of the Agreement of Sale is attached as Exhibit B hereto. The Agreement of Sale expressly stated that conveyance of full title would not take place until HUD reviewed customary procedures for such matters. Paragraph 3.A. title) so that the purchaser could seek low income housing tax credits from the

One of the most important provisions of the

under which the purchaser agreed to be bound by the terms of the project's Regulatory Agreement.

In September the purchaser appointed an affiliated organization, to manage the project. For the past two years, the purchaser has had full responsibility for the management and operations of the project.

is no longer the management

6-101

9/92

4350.1 REV-1

APPENDIX 4

agent for the project. Even though it retains legal title,

is no longer involved in the project's day-to-day functioning.

adequately repair the project and that HUD did not have enough funding available for this purpose. Accordingly,

At that time, for reasons not related to this project, HUD excluded the purchaser's and other affiliated organizations from further participation in HUD programs.

HUD also ordered the purchaser to reconvey, and the owner to reacquire, the interests which were transferred to the purchaser under the Agreement of Sale. As yet, neither the owner nor the purchaser have taken any steps to reconvey, and the purchaser continues in possession of the project.

E. Physical Deterioration

The project is in serious disrepair. HUD conducted a formal inspection of the project in and found numerous

health-threatening conditions, many of which had gone uncorrected for years. HUD representatives have returned to the project 4 or

9/92

6-102

4350.1 REV-1

APPENDIX 4

5 times since April 1990, and most of these unsafe conditions still exist. The facts surrounding the project's physical condition are summarized below and described in more detail in the attached Declaration of _____ which is attached as Exhibit C hereto.

One of the project's most pressing needs is for a new heating system. Last _____, the heat in numerous units went off at Christmas time and was only restored after emergency repairs were made. These repairs were at best a stopgap measure, and with the approach of winter, an entirely new system is urgently needed.

The project's plumbing has been a continuing problem. In almost all units, the bathroom fixtures leak into the kitchens below causing extensive damage to the walls, ceilings, floors and appliances. In many units, hot water is unavailable for days at a time. Raw sewage sometimes backs up into bathrooms.

Window glazing is deteriorated or missing throughout the project, permitting the windows to be easily blown or pushed out. The glazing around doors in the project is in the same condition.

Vandalism is rampant, particularly in the common areas and vacant units. Appliances have been ripped from walls and floors of vacant units and carted away. Large holes have been kicked in

the doors and walls, creating an attractive but dangerous place for the project's many children to play. Vandalism has been made worse by the absence of any on-site security. The project's

6-103

9/92

4350.1 REV-1

APPENDIX 4

outdoor lighting no longer works. The project is so dangerous that newspaper accounts have compared it to Dodge City.

In short, is a terrible place to live.

9/92

6-104

4350.1 REV-1

APPENDIX 4

II. ARGUMENT

The obligation of the defendants under the Regulatory Agreement to maintain the project in good condition and repair is crystal clear. Similarly, it is clear that the defendants have fallen far short of this standard and that the tenants are the ones who are suffering. For this reason, the government seeks enforcement of HUD's contractual right to take over and manage the project.

A. Summary Judgment May Be Granted Because There Are No Genuine Issues of material Fact

The only facts which are material to this motion concern the physical condition of the project and those facts are not in dispute. In fact, they are painfully apparent, The Declaration of provides an accurate, detailed and

unassailable narrative describing the present conditions at the project.

Summary judgment may be granted when, as in this case, there is no genuine issue of material fact. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S.Ct. 2502, 91 L.Ed.2d 202 (1986); *60 Ivy Corporation v. Alexander*, 822 F.2d 1432 (6th Cir. 1987). Where there is no such issue, summary judgment is an appropriate way to avoid a needless trial. *County of Oakland v. City of Berkeley*, 742 F.2d 289 (6th Cir. 1984).

6-105

9/92

4350.1 REV-1

APPENDIX 4

B. The Facts and Law Justify Placing HUD in Possession of the Project

As stated above, paragraph __ (c) of the Regulatory Agreement permits HUD, upon default, to

Take possession of the project...and operate the project in accordance with the terms of this Agreement until such time as the Secretary in his discretion determines that the owners are again in a position to operate the project in accordance with the terms of this Agreement.

While there are no reported cases which interpret this precise provision, several courts have invoked a comparable provision to give HUD control of a project, or to appoint a receiver to operate a project, pending foreclosure. /1

In some of these cases, the court has taken control of the project away from its owner solely on the basis of the contractual provision authorizing it to do so upon default of the owner's obligations. *United States v. Queen's Court Apartments*,

Ltd., 296 F.2d 534 (9th Cir. 1961); Garden Homes, Inc., v. United States, 207 F.2d 459 (1st Cir. 1953); United States v. Mountain Village Company, 424 F.Supp. 822 (D. Mass. 1976).

1/ A number of these cases concern the establishment of a receivership rather than the appointment of HUD to take possession of the project as requested here. But courts have consistently viewed a request to place HUD in possession as an alternative to a request for receivership, and will almost certainly apply the same standards when deciding whether to grant either request. See, United States v. St. Paul Missionary Public Housing, Inc., 575 F.Supp. 867 (N.D. Ohio 1983). See also, United States v. American National Bank and Trust Company of Chicago, 573 F.Supp. 1317 (N.D. Ill. 1983).

9/92

6-106

4350.1 REV-1

APPENDIX 4

It has long been the government's position that these cases state the correct view of the law. See e.g., View Crest Garden Apartments, Inc. v. United States, 281 F.2d 844 (9th Cir. 1960) at 846. Here, the defendants' default and HUD's contractual right to possession of the project are obvious. For this reason alone, the court should grant the present motion.

Notwithstanding the government's position on this issue, some courts have, without rejecting that position, looked beyond HUD's contractual rights to see if other, equitable factors exist which will persuade it to grant the request. One of the factors which courts have found relevant is the physical deterioration of the property and the danger of waste. United States v. Queen's Court Apartments, Inc., 288 F.2d 253, 255 (9th Cir. 1961); View Crest Garden Apartments, Inc. v. United States, 281 F.2d at 849.

See also, *United States v. Cedar-Riverside Land Company*, 592 F.2d 470 (8th Cir. 1979);

In addition, courts have also found that the policy behind the National Housing Act is a relevant consideration for the implementation of remedies at a HUD-involved project. The Federal interest in such projects is more than the protection of the public fisc. *United States v. Haddon Haciendas*. 541 F.2d 777, 784 (9th Cir. 1976). The Regulatory Agreement was designed to advance the policies of the National Housing Act, and the obligations imposed by the Regulatory Agreement upon "the owner were exacted in order to comply with the requirements of the

6-107

9/92

4350.1 REV-1

APPENDIX 4

National Housing Act and the Regulations ..." *Id.*, at 784. The Regulatory Agreement and the obligations it imposes on project owners are the primary means through which HUD enforces the Act.

If the court were to look for factors beyond the contractual provision permitting HUD to take possession, it would find them in abundance. There is more than sufficient evidence of physical deterioration at the project and waste. Indeed, the conditions at the project are inconsistent with National Housing Act objectives because they seriously jeopardize the health and safety of the tenants.

Admittedly, the project was in poor physical condition in September 1988 when the purchaser took control, but this is immaterial to the present motion. The motion is based on the

undeniable fact that the project is still in poor physical condition today, over two years later.

There is no doubt that both HUD and the purchaser have attempted to address the project's problems. The purchaser has spent substantial amounts of money in making repairs, but these expenditures have proven to be far too little too late. For its part, HUD worked with the owner and the purchaser before December 1987 to identify the project's physical problems and to find solutions to those problems. After December , HUD continued to provide Section 8 subsidy payments to the project and authorized both an increase in those payments and a rent increase

9/92

6-108

4350.1 REV-1

APPENDIX 4

that augmented project income by more than 27%. HUD has also obtained commitment from the insured private lenders to fund emergency repairs. In addition to all of these activities, HUD has also met with representatives of the tenants on a regular basis. See paragraph 22, , Exhibit C.

When all is said and done, however, it is the responsibility of the defendants, not HUD, to ensure that the project is properly maintained. It is the defendants, not HUD, who have assumed the burdens of ownership as well as the benefits. It is the defendants, not HUD, who have voluntarily agreed to keep the project in proper repair and to permit HUD to take over if they fail to comply with this crucial obligation.

The purchaser and its agent have controlled the project for

more than two years and have utterly failed to correct the very serious problems that exist. The court can only conclude from this that the defendants do not have the ability or the resources to make the needed repairs and that the tenants will continue to suffer so long as the defendants remain in control. For this reason, the only hope for the project and for the tenants is to enforce the explicit terms of the Regulatory Agreement and permit HUD to assume possession and to carry out an effective repair program.

6-109

9/92

4350.1 REV-1

APPENDIX 4

CONCLUSION

For the reasons described above, the government's motion for summary judgment should be granted.

Dated: _____, 1990

United States Attorney

a revised Chapter 6 to Handbook 4350.1, entitled
Project Monitoring.

9/92

6-110